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IN THE

Supreme Court of the United States

No. 71 - 1203

IN THE MATTER
of
LAS COLINAS, INC. and EASTERN SHORE DEVELOPMENT CORPORATION, DEBTORS

BANCO POPULAR DE PUERTO RICO,
Petitioner,

vs

LAS COLINAS, INC., EASTERN SHORE DEVELOPMENT CORPORATION and VIGDOR SCHREIBMAN,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

March 17, 1972

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

Petitioner Banco Popular de Puerto Rico respectfully prays that a writ of certiorari issue to review the judgments and opinions herein of the United States Court of Appeals for the First Circuit entered May 14, 1970 and December 21, 1971.

Opinions Below

The first decision of the United States District Court for the District of Puerto Rico and the first opinion of the Court of Appeals, entitled *Schreibman* v. *Mason* and reported at 377 F.2d 99 (1st Cir. 1967), did not address the

substance of the present controversy and are not relevant to this petition. The first decision of the district court on the merits is printed at A1—A44 of the Appendix (hereinafter cited "App.") and is reported at 294 F. Supp. 582 (D.P.R. 1968). The first decision of the court of appeals on the merits is printed at App. A45—A64 and is reported at 426 F.2d 1005 (1st Cir. 1970). The opinion and judgment of the district court on remand are unreported and are printed at App. A65—A80 and A81—A82, respectively. The final opinion of the court of appeals, as yet unreported, is printed at App. A83—A87.

Jurisdiction

The judgment of the Court of Appeals for the First Circuit was entered on December 21, 1971 and this petition was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. §1245(1).

Questions Presented

1. Whether, in the face of the requirement of Fed. R. Civ. P. 52(a) that facts be found "specially", a court of appeals is permitted to (a) affirm a district court's acceptance of respondents' "offer" to substitute cancellation of their debt to petitioner for findings of causation and amount of damages, (b) accept a renewal of that "offer" on appeal to avoid remand for the necessary hearings and (c) refuse to remand for a determination of damages, even though it recognizes that damages could have been determined with precision but for the "inconclusive" trial record.

2. Whether, by setting aside the findings of a district court and imposing its own interpretation of the evidence on that court, a court of appeals so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision, where (a) the court of appeals did not determine that the findings were clearly erroneous, (b) the findings were supported by

substantial evidence at trial and (c) an evaluation of the credibility of witnesses was crucial to a determination of the facts.

3. Whether the imposition on petitioner by the court of appeals, after trial, of the burden of proving at trial the fairness of the terms of a mortgage transaction, where there was no issue of fairness at trial and the burden was unknown under the statutory and case law of the forum, and the holding that by failing to meet the burden petitioner was liable in damages, coupled with a refusal to provide petitioner with an opportunity to meet the burden, was error and deprived petitioner of property without due process of law.

Constitutional Provision Involved

U.S. Const. amend. V (in part):

"[N]or shall any person . . . be deprived of life, liberty, or property without due process of law. . . ."

Statement of the Case

Respondents Las Colinas, Inc. and Eastern Shore Development Corporation are debtors in possession in arrangement proceedings under Chapter XI of the Bankruptcy Act commenced in the United States District Court for the District of Puerto Rico. Respondent Vigdor Schreibman is the principal stockholder of respondent corporations and appeared as an individual appellant in the first appeal on the merits. Petitioner Banco Popular de Puerto Rico (the "Bank") was a secured creditor in those proceedings prior to the decisions below, which cancelled respondents' debts to the Bank and ordered the Bank to return its security to respondents.

In September 1961, Vigdor Schreibman sought financing from the Bank for the construction of a residential and

recreational development on the eastern shore of Puerto Rico. The Bank granted an initial line of credit of slightly under $500,000, primarily for development of the land. The loans under that line of credit were later secured by a mortgage. (Loans were made to and the mortgage executed by Arenas, Inc., another Schreibman company, which was the predecessor of and was later merged into respondent Las Colinas, Inc. For ease of reference all transactions with and actions by respondents and their corporate predecessors shall be referred to as being with and by respondents.)

About a year later, before land development had been completed, the Bank granted respondents an addifional line of credit of $500,000 for construction of houses on part of the tract covered by the first mortgage. Loans advanced pursuant to the second line of credit were secured by an additional mortgage. The Bank expected, and respondents agreed, that all loans were to be repaid out of the proceeds of sales of houses and developed plots of land.

The parties dispute the number of houses that were to have been constructed and the time set for repayment of the loans. Initially the district judge held that 46 houses were to be constructed with those funds and that the loans were to be repaid within six months. App. A6, A7. After reversal and remand and without receiving any further evidence, the district judge doubled the number of houses to 92 and held that instead of being for a limited term the loans were to be revolving. App. A71, A73-A74.

In February or March 1963, after the two earlier lines of credit had been exhausted and without having completed the development of the land or the construction of a single house, respondents asked the Bank for additional financing. On June 13, 1963, the Bank approved a further line of credit of $750,000, secured by another mortgage. The Bank intended the proceeds of that loan to be used to complete the houses already under construction; however, instead of completing a single house, respondents used most of the

$750,000 for studies of future development and for work on additional houses.

In May 1963, respondents submitted to the Bank a final budget estimating total construction cost for the first section of the development at over $2,700,000, including site development, the construction of 92 houses and three model houses and administrative expenses. There is a sharp dispute as to whether the Bank agreed to finance that entire plan. Respondents claim that it did and that the financing was to be accomplished by "revolving" the $1,750,000 line which had been extended. Again, the district judge reversed himself and made diametrically opposite findings on this point on the same evidence. Compare App. A9 ("credit . . . not of a revolving character") with App. A73-74 ("the Bank did . . . commit itself to revolve the line of credit").

By December 1963, the Bank had advanced approximately $26,000 more than the maximum of the lines of credit, but respondents still had not completed a single house and were not in a position to sell a single developed lot. That being the case, the Bank refused respondents' request for further credit, but negotiated with respondents as to possible further financing of the project.*

In the process of the negotiations for further financing, and after Schreibman had reported his inability to obtain financing elsewhere, on December 20, 1963, respondents executed a $2,000,000 note and mortgage to the Bank, partly as security for any further advances and partly to replace the earlier $750,000 mortgage, which inadvertently had been secured by an undeveloped tract of land.** The $2,000,000

* At the urging of the Bank, during 1963 respondents attempted to obtain financing from other sources. The Bank assisted respondents in their efforts. In early December Schreibman advised the Bank that those efforts had proved fruitless and that respondents were unable to obtain financing from any other source.

** Whatever the amount of the notes and mortgages, respondents would, of course, only be liable for the amount actually outstanding on the loans. The Bank has never demanded more.

note and mortgage were authorized at a meeting of the board of directors of respondents Las Colinas, Inc. ("Las Colinas") by unanimous vote of the directors present: Schreibman, another Las Colinas officer and two officers of the Bank; they were thereafter approved by a fifth director, Tomas I. Nido, who was an attorney for Las Colinas and who prepared the mortgage.

For the next several months, the parties attempted without success to negotiate an arrangement for the Bank to continue financing the development. Finally, in June 1964, the Bank made formal demand for repayment of the loans and in July of that year commenced an action in Superior Court, Humacao County, Puerto Rico, for judgment on the debt and to foreclose the mortgages.* On October 5, 1967, pursuant to stipulation among the parties, the district court took jurisdiction to resolve the Superior Court action as part of the Chapter XI proceedings.

Reasons for Granting the Writ

The courts below have disregarded their duty to determine both the fact and the amount of damages accurately and with particularity, thereby departing from required standards of judicial procedure. Further, the court of appeals vacated crucial findings of the district court without determining that they were clearly erroneous. Moreover, the critical tone of the circuit court in reversing these findings seems to have so intimidated District Judge Cancio that on remand he quoted and adopted as findings mere questions and comments of the court of appeals and made findings of fact directly opposite to his initial findings without receiving a shred of further evidence. Finally, the court of appeals created and imposed retroactively on

* The four mortgages referred to secured bearer notes. In addition, as each advance was made under the lines of credit, respondents executed demand notes to the order of the Bank for the specific amount of each advance. These "order notes" eventually numbered 83 and totalled $1,776,532.63.

petitioner a burden of proof on an issue which had not been raised before or during trial and was unknown under Puerto Rican law, and held that petitioner had failed to meet that burden while refusing to provide petitioner an opportunity to attempt to satisfy that burden. It thereby deprived petitioner of property without due process.

The circuit court's departure from accepted and usual judicial proceedings and its affirmance of such departure by the district court calls for an exercise of this Court's power of supervision. The deprivation of petitioner's property without due process demands review by this Court.

I

Fed. R. Civ. P. 52(a) provides that "the court shall find the facts specially and state separately its conclusions of law thereon." *Hatahley* v. *United States*, 351 U.S. 173, 182 (1956), enunciated the rule "that findings of damages be made with sufficient particularity so that they may be reviewed." The courts below have ignored both rules. Instead, there was merely an acceptance by the district judge of respondents' "offer" to forego their claim in exchange for cancellation of their debt to the Bank. The subsequent opinion of the court of appeals makes clear that it affirmed that short-cut simply to put an end to lengthy litigation.

The mandate of the court of appeals on remand following the first substantive appeal was clear: "On the issue concerning the execution of the $2,000,000 mortgage, the case is remanded for a determination of damages." App. A64.

But on remand, the district court did not hold any damage hearings, did not limit damages to those caused by the $2,000,000 mortgage and never really considered the question of the relationship of any loss by the respondents to any action by the Bank; instead it merely estimated the "loss" at an amount equal to the Bank's claims in order

to produce a convenient set-off. The opinion on remand states only the conclusion that the Bank "prevented and hindered the developers from completing the work and selling the lots and houses," by breaching the agreement to lend money and by a breach of trust of the Bank's officers regarding the $2,000,000 mortgage transaction. App. A77. The opinion does not set forth any theory of causation linking the Bank to respondents' failure to complete the development, nor does it contain a single item of damages resulting from the Bank's conduct. Of course, there must be a showing of causation before there can be a finding of damages. McCormick, Damages § 73 at 261 (1935).

In fact, the poor financial condition in which the respondents found themselves prior to the decisions below could well be attributable to their failure to complete one set of houses before commencing another set, failure to keep a tight rein on costs during the life of the project, inability to work with any of the succession of contractors they retained, failure to obtain additional financing, and other similar causes. Petitioner does not now contend that any of those factors was proven to be the cause of the respondents' inability to meet their obligations (there was no hearing on remand at which such proof could have been offered); rather, it contends that the district court failed completely to make any findings on the subject and such failure constitutes reversible error.

Not only did the district court fail to determine the fact of damages, it made no finding at all as to the amount of damages. The only discussion of the subject of damages in its 15-page opinion is the statement in one conclusory paragraph that "damages .... were, of course, severe." App. A80. It was that "finding" that the court of appeals affirmed.

It is well settled that when a trial is by a court without a jury "the determination of damages is a question of fact." *Traylor* v. *United States*, 396 F.2d 837, 839 (6th Cir.

1968) (citing cases from other circuits). Thus, Rule 52(a) dictates that a court state adequate findings of damages, and a court may not waive compliance with that rule. *Berguido* v. *Eastern Air Lines, Inc.*, 369 F.2d 874 (3d Cir. 1966). Indeed, this Court, in *Hatahley*, emphasized the importance of particularity in determination of damages.

The failure of the district court on remand to follow the mandate to the letter was error. As this Court has held, "an inferior court has no *power* or *authority* to deviate from the mandate issued by an appellate court." *Briggs* v. *Pennsylvania R. Co.*, 334 U.S. 304, 306 (1948) (emphasis added), citing *Sibbald* v. *United States*, 12 Pet. (37 U.S.) 488 (1838). On appeal, the first circuit recognized the lower court's failure to follow its mandate, when in classic understatement it said "the district court did not follow with precision the course we charted." App. A86. However, the circuit court chose not only to ignore the district court's error, but it embraced that error by accepting respondents' "offer" to "let matters stand as the district court disposed of them." App. A86. In support of this novel approach the court of appeals merely stated that the result was "sensible" and "consistent with the nature of the claims made" and that remand for proper damage findings would "only protract already over-extended litigation." App. A86, A87.

This Court has held, in *Kelley* v. *Everglades Drainage District*, 319 U.S. 415, 420, *rehearing denied* 320 U.S. 214 (1943), that where an issue has many facets

> there must be findings, *in such detail and exactness as the nature of the case permits*, of subsidiary facts on which the ultimate conclusion ... . can rationally be predicated. (Emphasis added.)

Instead, the circuit court here was presented only with conclusions on a damages question which it recognized would require detailed and complex findings. App. A86-A87.

The circuit court stated that damages properly should have been measured by weighing "the increases in costs of completion stemming from the changes in economic conditions between 1963 and 1970; additional administrative . . . expenses . . . lost revenues from rental of all houses and lots on the section being developed; [and] their lost interest on the value of land not being developed" against "[w]hat costs would have been, what sales or rentals would have been, what the economy would have been for buyers and borrowers, in a relatively undeveloped and remote part of Puerto Rico," and by asking whether respondents could prove that "completion would have proceeded without complication, that all houses and lots in their developed area would have been sold or rented without difficulty, and that even their undeveloped land would have a market." App. A86. As to the record, which it characterized as "inconclusive", the court said

> [respondents] have woven a fine skein from the testimony of various witnesses, arriving at a grand total of damages of $4,533,324. But many of the threads are fragile, and the final web is too gossamer to bear weight. App. A86.

Comparing respondents' evidence on damages with the factors it had enumerated, the court admitted

> Were we to remand for a more precise determination, we would think it probable that a substantial part of the damages claimed would be deemed too speculative and remote. App. A86-A87.

Since the district court made no findings as to damages, the court of appeals, in effect, was making its own findings. This was improper, since "it is not the duty or the right of [appellate courts] to make independent determinations." *Johnson* v. *United States*, 256 F.2d 849, 850 (5th Cir. 1958). The proper method was used in *Carpenters Local 1273 of United Bro. of C. & J.* v. *Hill*, 398 F.2d 360 (9th Cir. 1968). There, the plaintiff was awarded, without discussion, a lump sum as damages where damages claimed were of a

highly detailed and technical nature. Citing *Hatahley* and Rule 52(a), the court remanded for supplemental findings, directing that the lower court "at least state the method of computation of damages and the amount awarded for each element." 398 F.2d at 363.

By its decision below, the court of appeals also repudiated the reasoning of one of its earlier decisions in which it recognized the need to remand for an adequate determination of damages, *Mitchell* v. *Evelyn C. Brown, Inc.*, 310 F.2d 420 (1st Cir. 1962). It replied in that case to a request that the appellate court determine damages rather than remand by saying, "We have been slow to make independent findings of damages . . . and our only recent exception has been when we believed we were in exactly the same position as the district court." 310 F.2d at 426. Clearly that was not the case here, where credibility of the witnesses was crucial; the district court was in a far superior position to judge than was the circuit court.

The proceedings below have totally abrogated both the letter and the intent of Rule 52(a) and conflict with decisions of this Court. Acknowledging that it, too, was accepting respondents' "offer" to settle rather than be put to their proof for damages, the circuit court cancelled respondents' debt to the Bank in excess of $1,760,000, plus nearly $1,000,000 in interest, as payment of a claim which is not specified in the trial court's findings. The court of appeals accepted the offer, despite the "inconclusive record" before it. Apparently, it affirmed at the expense of the Bank's rights so as not to "protract" the litigation. App. A87.

The Bank has never had its day in court on the question of whether, or to what extent, it is liable in damages. It is submitted that the court of appeals

> has so far departed from the accepted and usual course of judicial proceedings [*and*] so far sanctioned such a departure by a lower court, as to call for an exercise

of this court's power of supervision. Supreme Court Rule 19(1)(b).

We urge this Court to grant review in this case and to reaffirm the principle that fundamental rights should not be sacrificed in the name of judicial efficiency or simply because litigation is protracted.

II

The court of appeals refused to accord the district court's initial findings the weight required by Rule 52(a) and erred in setting them aside without determining that they were clearly erroneous. Having taken that step the court of appeals then improperly embarked on fact finding of its own and, in the process, apparently so intimidated the district judge that on remand, on precisely the same evidence as was before him when he rendered his first opinion, the district judge reached opposite findings on every significant issue, even parroting as fact "questions" raised by the higher court. It must be concluded that the lower court was not influenced by the evidence but, rather, was reacting to the criticism and the direct and implied determinations of fact by the court of appeals.

In its earlier opinion, the district court held, in part, that the Bank had justifiably and reasonably refused to advance further loans to respondents and, in that connection, held that the loans were for a specific term, and were not granted under a revolving line of credit. The court therefore concluded that the Bank had not incurred any obligation to lend further funds.* App. A9, A10.

At the outset of its first opinion, the court of appeals chastised the lower court for having adopted almost ver-

*It should be noted that even if the line of credit were revolving, in December 1963 when the full amount of the line had been advanced, respondents were unable to start repaying any part of the loans and thus could not have required the Bank to start the line of credit "revolving".

batim the proposed findings of fact and conclusions of law which had been submitted by counsel for the Bank. Since that had been done, the court concluded that it should make "the most searching examination for error," that "maximum doubt is cast on the findings of fact by their adoption from the litigant's proposals" and that it should be "more careful" in its review. App. A49-A50. According the opinion less weight than usual because of its source rather than its content, was error compelling review by this Court.

The court misconstrued both Rule 52(a) and the case on which it purportedly relied, and ignored the "well established appellate procedure [that a court] must view the evidence in the light most favorable to the prevailing party." *Axelbank* v. *Rony,* 277 F.2d 314, 316 (9th Cir. 1960). See also *Dillon* v. *M.S. Oriental Inventor,* 426 F.2d 977, 978 (5th Cir.), *cert. denied* 400 U.S. 903 (1970).

> Rule 52(a) provides, in relevant part:
>
> Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses.

Admittedly, appellate courts have frowned on trial courts which have adopted extensively findings submitted by one of the litigants, but the "clearly erroneous" test is still applied to such findings. In *United States* v. *Cornish,* 348 F.2d 175, 181 n.8 (9th Cir. 1965), the court responded to an argument that adopted opinions deserve less credit as follows:

> If a finding is to be set aside it must be because it is clearly erroneous, not because it is derived from a particular source.

The first circuit cited *Louis Dreyfus & Cie.* v. *Panama Canal Co.,* 298 F.2d 733 (5th Cir. 1962), as precedent for

its departure from Rule 52(a) in this case. *Dreyfus*, however, is contrary to the first circuit's decision because there the court, although critical of the procedure used by the district court (the verbatim adoption of findings proposed by one of the parties), applied the "clearly erroneous" rule and affirmed the findings below.

The first circuit cited, but also failed to follow, *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651 (1964). In *El Paso* the district court also adopted verbatim the findings of fact and conclusions of law submitted by one of the parties. The opinion by Mr. Justice Douglas criticized the practice followed by the lower court, but held:

> Those findings, though not the product of the workings of the district judge's mind, are formally his; they are not to be rejected out of hand, and they will stand if supported by evidence. 376 U.S. at 656.

The first circuit overturned findings of the district court without determining anywhere in its opinion that those findings were clearly erroneous and in the face of the fact that the findings it overruled were supported by substantial evidence.

The record on the trial of this case more than meets the test of *El Paso*. The loan agreement was oral, so there was no direct documentary evidence on the question whether the line of credit was to revolve. Schreibman testified to oral agreements with Abner Kalisch, Executive Vice President of the Bank, that the line was to revolve. Kalisch and two other Bank officers, José Luis Carrion and Arnoldo Soto, all denied any such agreement. There were admitted into evidence documents which could lend circumstantial support to either position. As the court of appeals recognized, the finder of fact had to face and decide "numerous issues and sharply disputed facts founded upon evidence largely oral in nature." App. A50. He and he alone was in the position to judge the credibility of witnesses. Obviously, the trial court was convinced by the testimony of the Bank.

This Court has directed that where facts must be elicited from contradictory testimony, Rule 52(a)

> requires that an appellate court make allowance for the advantages possessed by the trial court in appraising the significance of conflicting testimony, and reverse only "clearly erroneous" findings. *Gracer Tank & Mfg.* v. *Linde Air Prod.*, 336 U.S. 271, 275 (1949), *rehearing denied* 340 U.S. 845 (1950).

If the court of appeals found Judge Cancio's procedure inadequate and thought that he had not sufficiently evaluated the evidence, the most it should have done was to remand for further findings. Instead the court of appeals ignored the "advantages possessed" by the trial judge and simply discarded his findings. This is a sharp departure from proper judicial procedure under Rule 52(a) and so violates the letter and policy of the rule as to demand correction by this Court.

III

The court of appeals imposed on petitioner, after trial, the burden of proving at trial the fairness of the terms of the $2,000,000 mortgage transaction and held that petitioner had failed to meet the burden. Since there had not been an issue at trial as to fairness of the terms and since the civil law system of Puerto Rico did not put the petitioner on notice of the existence of such a burden, the retroactive imposition of the burden and the determination that petitioner had failed to meet it and was liable in damages, coupled with refusal to provide petitioner with an opportunity to meet the burden, was error and deprived petitioner of property without due process of law.

The first circuit stated that the mere fact that two officers of the Bank sat on the board of directors of respondent Las Colinas and voted to approve the $2,000,000 mortgage, "casts upon those who seek to uphold the transaction the burden of showing that it is fair and absolutely free from fraud," citing *Irving Bank—Columbia Trust Company* v. *Stoddard*, 292 F. 815 (1st Cir. 1923). App. A58.

The court also relied on *Geddes* v. *Anaconda Copper Mining Company*, 254 U.S. 590 (1921), for the same proposition, reasoning that there was no distinction between the *Geddes* situation (interlocking directorates) and the situation at bar (officers of one corporation acting as directors of another). The court of appeals missed a key distinction between those cases and the case at bar. In both *Irving Bank* and *Geddes* it was the opposing party, not the fact of interrelated management, which cast the burden of proving fairness on the party seeking to uphold the transaction.

In *Irving Bank*, officers from various banks demanded and received control of a financially unsound corporation as a condition to a loan. A subsequent loan between the banks and the corporation was negotiated by the same officers and secured by an assignment of the corporation's receivables to Irving Bank as trustee for the other lenders. After a receiver of the corporation was appointed, Irving Bank sued to recover certain funds collected by the receiver from the corporation's debtors. The receiver defended on the grounds that the security agreements being sued on were voidable because they had been executed by the same persons for both parties, and must be voided because their terms were unfair. The court said that "a clear, sharp issue of fact was presented by the petition and answer." 292 F. at 819.

That the burden of proving fairness arises when the issue of fairness is raised by the other party was also held by this Court in *Geddes*. There, minority stockholders attacked the sale of all of the property of their corporation to Anaconda Copper on the ground, *inter alia*, that the sale was negotiated by two boards of directors with common membership. After affirming that there was indeed a common control, Mr. Justice Clarke stated the oft-quoted rule:

> The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the

> law as are personal dealings between a director and his corporation; *and where the fairness of such transactions is challenged,* the burden is upon those who would maintain them to show their entire fairness. . . . 254 U.S. at 599. (Emphasis added.)

Significantly, in the two decisions relied on by the court of appeals as authority for imposing the burden of proving fairness on the Bank, the fairness of the transactions was challenged prior to trial. In the case at bar, however, the issue of the fairness of the substance of the $2,000,000 mortgage transaction was raised for the first time on appeal. While respondents' pleadings, evidence and proposed findings raised issues as to possible fraud by the Bank in procurement of the mortgage, it was not until their brief on appeal that respondents asserted that the mortgage itself was an unfair business transaction, the terms of which caused them economic harm.

The court of appeals clearly was concerned with the substance, not the procurement, of the $2,000,000 mortgage. App. A58-A60. It held that the Bank failed to prove fairness—which the court seemed to equate with economic purpose—and that the Bank must therefore respond in damages. The court ruled that the Bank had that burden even though it recognized that such a burden had not been imposed by the Puerto Rican civil law system.* App. A58. The court of appeals should have provided an opportunity on remand for the Bank to meet the burden because the Bank could not reasonably have foreseen a burden of proof unknown under its law. Although surprise does not neces-

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* There are some jurisdictions in which the mere existence of interlocking management creates a burden of proof of fairness to be met by one seeking to uphold the transaction. However, most decisions require such a proof of fairness only after a challenge has been made. See Anno., 33 A.L.R. 2d 1060, 1072-75 (1954). Most importantly, since the Supreme Court of Puerto Rico had not passed on this issue (App. A58), the Bank had no reason to suspect any deviation from the general rule that fraud is "never presumed." *United States* v. *Wunderlich,* 342 U.S. 98, 100 (1951).

sarily constitute a deprivation of due process, when, as here, after several years of litigation, a party has imposed on it a burden of proof unknown under its local law and which it could not reasonably have foreseen, and is then denied an opportunity to meet that burden, such surprise rises to the level of a deprivation of due process. See *Market Street R. Co.* v. *Railroad Comm. of Cal.*, 324 U.S. 548 (1945).

Conclusion

For the foregoing reasons, a writ of certiorari should issue to review the judgments and decisions of the United States Court of Appeals for the First Circuit.

March 17, 1972

Respectfully submitted,

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APPENDIX

APPENDIX

Opinion of the District Court for Puerto Rico, per Cancio, Chief Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

No. B-38-64

IN THE MATTER

of

LAS COLINAS, INC. and EASTERN SHORE DEVELOPMENT CORPORATION,

Debtors.

December 4, 1968

FINDINGS OF FACT AND CONCLUSIONS OF LAW

CANCIO, Chief Judge.

On October 15, 1964, Las Colinas, Inc., and Eastern Shore Development Corporation filed a petition proposing an arrangement with their creditors under the provisions of Chapter XI of the Bankruptcy Act. After several hearings and incidents, Debtors and one of the creditors, a bank known as Banco Popular de Puerto Rico, signed a stipulation on September 19, 1967, wherein it was agreed by both parties that this Court had jurisdiction over all the parties and all matters involved in these proceedings, and that foreclosure proceedings pending in the Superior Court of Puerto Rico, Humacao Part, should be perma-

nently enjoined and the proceedings terminated. It was also agreed and stipulated that this Court should render a judgment on the merits on all disputes and controversies between Debtors and Banco Popular de Puerto Rico. The above mentioned stipulation was approved by this Court on October 4, 1967.

The final hearings in these proceedings were held on the 25th, 26th, 27th and 28th of March and continued during the week beginning on the 1st of April, and were concluded on April 8, 1968. On April 8, 1968, this Court ordered the parties to file proposed findings of fact and conclusions of law. They have done so.

Findings of Fact

On or about September of 1961, Vigdor Schreibman, President of Arenas, Inc., submitted to Abner Kalisch, Vice-President of Banco Popular, a proposal requesting the financial backing of said banking institution for the development of land in the Municipality of Luquillo, Puerto Rico. The development would comprise several parcels of land bought by Arenas, Inc., and other corporation, Las Colinas, Inc., during the years 1961 and 1962. Mr. Vigdor Schreibman was the President of both corporations as well as the principal stockholder, since he owned more than 52% of all the stock issued by both. There is no doubt that in the early negotiations, the only persons who participated were Mr. Vigdor Schreibman, representing the developing corporations, and Mr. Abner Kalisch, representing Banco Popular de Puerto Rico. There is no written document with respect to the early conversations between Mr. Schreibman and Mr. Kalisch.

The nature of Arenas' request was that said corporation and other subsidiaries were planning a residential and

recreational development to be known as "Las Colinas Development." These corporations were requesting the interim financing of the development. At first, the Bank informed Mr. Schreibman that it was interested in providing financial assistance by stages if certain conditions were met.

Considering the documentary and oral evidence as a whole there is no doubt that Banco Popular initially agreed to finance the development of a 50-cuerda tract into 125 lots and that it later agreed to finance the construction of 46 houses that were already sold. The granting of further financial assistance for the development of the project and for the construction of more houses, buildings and facilities was conditioned on the outcome of the First Section of the Development.

In order to obtain the financial assistance for the development of the First Section, Arenas, Inc., the predecessor of Las Colinas, Inc., submitted to the Bank certain plans, blueprints, budgets, cost estimates and projections as to the time it would take to finish the work for the development of the land, sale of lots without houses and the amount of money Arenas, Inc., was to receive from the sale of said lots. On the basis of this information, Banco Popular approved a line of credit for the development of the land in the amount of $482,000.00. It was agreed that the advances to be made under this line of credit would pay interest at a rate of 6½% per annum and that Arenas, Inc., was to pay Banco Popular a commission equivalent to 1% of the total amount of each advance payment received.

The original line of credit approved by Banco Popular in the amount of $482,000.00 was not intended solely for the development of land or site improvement. The Court is aware that on several occasions during the period of time this line of credit was in effect, Arenas, Inc., re-

quested certain sums of money for purposes other than "site improvement." There is no evidence that Banco Popular intended to grant or did grant a credit for these additional expenses. On the contrary, there is evidence that the Bank repeatedly told the officers of Arenas, Inc., and later of Las Colinas, Inc., that said corporation had to raise more working capital, necessary for administrative expenses and general overhead. On the basis of what has been stated above, we have to conclude that under the original line of credit of $482,000.00, the Bank advanced money to Arenas, Inc., that was not intended to pay the cost of developing the land. This conclusion is further strengthened by the fact that although a line of credit was approved in the amount of $482,000.00, the cost of developing the land in the First Section was estimated at approximately $318,000.00, on the basis of the then existing construction contract between Arenas, Inc., and the General Contractors, Alpha-Burke Wilhelm.

There is no room for doubt that Banco Popular granted the credits for the development of land as well as for the construction of houses, considering that the source of payment would be the sale of the lots and the sale of the lots and houses. This Court has before it a memorandum prepared by the Bank for the guidance of the Bank's officials and of the Bank's Credit Committee, that unequivocally establishes this fact. Besides, the financial situation of Arenas, Inc., Las Colinas, Inc., and Eastern Shore Development Corporation, the last two corporations assisting the first in the development of the project, strengthens this conclusion. Arenas, Inc., and Las Colinas, Inc., had purchased approximately 700 cuerdas of land for the whole project at an approximate cost of $700,000.00. Said corporations paid only around $220,000.00 in cash of the total purchase price of the land bought, owing the

balance. The total capital of these corporations was about $436,000.00 in investments in capital obligations and $3,000.00 as paid in capital.

Debtors' assertion that the credit facilities granted were to be paid with the proceeds of the sales of the lots and of the lots and houses, regardless of the period of time Arenas, Inc., would take to finish the works of development of land, of house construction and sale of same, is quite improbable, since it is contrary to business sense and to common sense. Considering all the evidence submitted, there is room for only one conclusion: Banco Popular granted a line of credit for the development of land in the First Section of the project and later granted another line of credit for the construction of houses. We also have to conclude that in granting said lines of credit it was considered that the sale of lots and lots with houses was to be the source of payment and that said payment or payments were to be expected within the projections submitted or at least within a reasonable period of time after the projected time for the completion of the development of land and house construction.

The first line of credit was approved by Banco Popular on September 19, 1961. According to the projections submitted by Arenas, Inc. to Banco Popular, and according to the frequent conversations between the officials of both parties, it was expected that the works on the development of land were to be completed in six (6) months after breaking ground. Regarding this aspect, there is no doubt that the works were not carried out as scheduled. On the contrary, there was some delay and the works on the land development or site improvement did not start until April 1962.

On September 18, 1962, and before the land development was completed, Banco Popular granted an additional

line of credit to Arenas, Inc., this time in the amount of $500,000.00 for the construction of forty-six (46) houses. This line of credit was granted under the same conditions as the prior line of credit, except that the rate of interest was reduced to 6%. The payment of the amounts advanced under this line of credit was to be made from the proceeds of the sales of lots and houses in the First Section of the project. The time of payment is again in controversy, but there is no doubt that the parties projected that the houses were to be completed within a period of approximately six (6) months, or by February or March, 1963. Neither the site improvement nor the construction of houses was completed within the projected period of time. As a matter of fact, it was never completed. The evidence as a whole establishes that Arenas, Inc., had difficulties with the contractors since the beginning; that these difficulties, plus delays in the works already started, as well as the fact that Arenas, Inc., spent part of the sums advanced for plans, surveys and studies for the development of another forty cuerdas tract that comprised Section Two of the project, resulted in the inability to complete the work on time and in insufficient funds with which to finance the completion of the work. The delays also increased the costs, and these facts prevented completion of the land improvement and of the construction of houses according to the cost estimates and projections originally accepted and referred to above.

Debtors tried to establish that there was no agreement as to the time within which the development of the land and the construction of houses was to be completed. They also asserted that the advances made under the lines of credit were not to be paid until the lots or houses were sold. Despite the fact that the projections submitted to Banco Popular were part of the transaction and were made

to induce said banking institution to grant the lines of credit, and that said projections were considered by the Bank to determine the cost of the works to be undertaken in Section One and the selling price of the lots and houses, they also refute the assertion that the Bank had agreed to readjust the financial commitments according to preliminary or additional budgets to be submitted by Debtors. Said assertion flies in the face of common sense since it is most improbable that a bank or any other financial institution would undertake to make a loan without establishing when, how, and from what sources the loan is to be paid back. The most rational and equitable conclusion that can be reached from the voluminous evidence before us is that the two lines of credit granted in the amounts of $482,000.00 and $500,000.00, as well as the advances made later in excess of these two lines of credit, represented a total amount which the parties felt was sufficient to complete the works as proposed and that any amount loaned was to be paid from the proceeds of the sale of lots and houses immediately after completion of the works. We cannot conclude that a period of time was not fixed for the completion of site improvement and house construction. On the contrary, the six-month period seems to be the period of time agreed upon, considering the kind of work involved and the testimony of the Bank's officials in these proceedings.

Neither land improvement of the First Section nor the construction of houses was completed by February or March, 1963. Nevertheless, on June 18, 1963, Banco Popular increased the line of credit up to $1,750,000.00. This increase was made to provide Arenas, Inc., with sufficient funds to finish the works of the development of land and the construction of 46 houses. The parties agreed that the rate of interest was to be 6% on the loans for house construction and 6½% on the loans for development

of land or site improvement. The Court has no evidence as to the extension of time to complete the works.

Although, as we stated before, the line of credit was increased so that the developers could finish the works of the development of land in the First Section and the construction of 46 houses, it is an undisputed fact that the developers had undertaken the construction of more than 46 houses. This is established by the construction contract signed by the developers (Arenas, Inc.) and the contractors (Rodríguez & Del Valle, Inc.), on February 1, 1963. By February 18, 1963, Arenas, Inc. was in the process of constructing more than 46 houses. We are convinced that Banco Popular acquired knowledge of this fact and that it consented to, even if not willingly, the construction of more than 46 houses. There is the testimony of a Bank official to the effect that the amount of $1,400.00 was approved for each house in excess of the 46 that were under construction. The same official authorized loans for the partial payment of a mortgage which encumbered part of the land on which these additional houses were being constructed and for the payment of other debts and obligations of Arenas, Inc. From all the above, it is reasonable to infer that when in June 18, 1963 Banco Popular increased the line of credit to $1,750,000.00, the parties took these additional costs in consideration in fixing a new maximum line of credit. However, there is evidence to convince the Court that not only Las Colinas, Inc., but also Rodríguez & Del Valle, Inc., knew that Banco Popular would not advance the necessary funds to cover the entire cost of construction of the additional houses and that the contractors would have to wait until the additional houses were sold to obtain payment of the full cost of construction.

Considering the evidence as a whole, we are convinced that Banco Popular never increased or approved lines of

credit to Arenas, Inc. for more than $1,750,000.00. Once this credit was exhausted, or was almost exhausted, and all the interest paid up to November 25, 1963, Banco Popular refused to approve and to pay a new requisition submitted by Arenas, Inc., for approximately $26,000.00. This amount was requested in order to pay the payroll for the month of November 1963. It was not until December 27, 1963, and after some meetings with Mr. Vigdor Schreibman, President of Arenas, Inc., that Banco Popular authorized the payment of this requisition and that the amount thereof was credited to the account of Arenas, Inc. It was at this time that Banco Popular received as pledgee and as collateral security to all debts a bearer mortgage note in the amount of $2,000,000.00.

We also have to conclude that the line of credit approved in the amount of $1,750,000.00 was not of a revolving character. The evidence before this Court convinces us that Banco Popular only committed itself to grant credit up to the amount mentioned above, and that it was willing to undertake the financing of additional work depending on the outcome of the work in process on the First Section of the Las Colinas Project. The Court is not convinced that a banking institution would commit itself to finance a multimillion dollar project without waiting to find out how the first stages of the project are carried out. We are convinced that Banco Popular may have expressed its willingness to finance the whole project depending on the results achieved upon completion of the First Section and after the lots and houses in that section had been sold. The additional loans that were granted—one in the approximate amount of $26,000.00 and the other to pay the notarial fees and other expenses of the $2,000,000.00 mortgage and its recordation in the Registry of Property—were considered and granted separately while new nego-

tiations and conversations were being held between the Bank and Debtors for additional credit. These negotiations proved fruitless, as the Bank refused to lend additional funds.

We have already stated that when the line of credit was increased to $1,750,000.00, the parties did not agree on an additional period of time for completion of the works in Section One or for the payment of the debt. It would be absurd to conclude that when on June 18, 1963 Banco Popular granted the additional credit requested to finish the land development on the First Section and the construction of houses in that section, it did not take into consideration the fact that the completion of said work was to take some time. There is no conclusive evidence as to the existence of an express agreement regarding the time the parties thought would be required to finish the works already started. However, if the line of credit was increased to the sum of $1,750,000.00 in order to provide for the completion of the Section One works, then these works should have been completed during December 1963, when the credit was almost totally exhausted. Instead, we find that: (1) The houses were far from finished and the other work was still not completed. (2) The credit became exhausted and there were no other resources with which to finance the completion of these works. Therefore, in the absence of conclusive evidence to the effect that the loans were to be payable at a later date, we must conclude that at the time this situation arose, Banco Popular was entitled to demand payment of all the sums owed to it.

The debt is evidenced by eighty-three notes that altogether add up to the sum of $1,776,532.63. All notes are payable on demand, to the order of Banco Popular de Puerto Rico, which is the owner and holder of said notes.

Opinion of the District Court for Puerto Rico, per Cancio, Chief Judge.

Although from the face of all notes it is sometimes impossible to determine the rate of interest agreed for each one, there was sufficient evidence presented to the Court to clearly establish that, as to the first credit of $482,000.00, the rate of interest agreed upon was 6½%. There was contradictory evidence as to the rate of interest agreed upon for the balance of the amount loaned, which forces us to conclude that the balance of the loan up to $1,776,532.63 should earn interest at a rate of 6% per annum, which was the lower rate agreed upon.

Interest accrued until December 27, 1963 was totally paid, which means that Debtors owe to Banco Popular the principal sum of $1,776,532.63, with interest at 6½% per annum on the first $482,000.00 from December 28, 1963, and interest at 6% per annum on the difference from the same date. According to the text of each note, Debtors agreed to pay the expenses, costs and attorneys' fees in case foreclosure proceedings were necessary to collect the amount owed, in the amount of 10% of the principal sum of each note. In other words, besides the principal and interests owed, Debtors owe to Banco Popular de Puerto Rico the sum of $177,653.26 for costs, expenses and attorneys' fees.

The whole debt, including principal, interests, costs, expenses and attorneys' fees, was secured by three (3) bearer mortgage notes that were delivered to Banco Popular as collateral security or pledge. The first mortgage note, hereinafter called "First Arena Mortgage Note", is in the principal amount of $500,000.00 and was issued by Arenas, Inc. on April 26, 1962. This mortgage note is payable to the bearer on demand with interest at 6½% per annum. It is secured by a mortgage constituted by Deed Number 53, executed on April 26, 1962, before Notary Rafael Baragaño Diez. The second mortgage note, hereinafter called

"Second Arenas Mortgage Note," was issued by Arenas, Inc. on February 5, 1963, and is payable to the bearer on demand. This second note is in the principal amount of $500,000.00, with interest at 6% per annum, and is secured by a mortgage constituted by Deed Number 26, executed on February 5, 1963 before Notary Edilberto Berríos Dávila. The third note, in the principal amount of $2,000,000.00. with interest thereon at the rate of 6% per annum, was issued by Las Colinas, Inc. on December 20, 1963. This third mortgage note was signed by Vigdor Schreibman as President of Las Colinas, Inc., and is secured by a mortgage constituted by Deed Number 374, executed on December 1963, before Notary Edilberto Berríos Dávila.

The mortgages encumber two parcels of one hundred (100) cuerdas each, located in the Demajagua Ward of the Municipality of Fajardo, Puerto Rico. Both parcels were free of liens or encumbrances and the development of land and the construction of houses were taking place in one of them. The remaining land which we have referred to was subject to mortgages securing the purchase price owed, which totalled around $480,000.00.

On April 26, 1962, the same date the first mortgage was executed, Arenas, Inc. executed and delivered to Banco Popular a general pledge agreement in favor of the Bank. This document was signed and executed before a notary public by Joseph K. Summers, as Vice President of Arenas, Inc. According to this document, all securities already delivered or to be delivered in the future to Banco Popular would constitute security for the payment of debts and obligations already contracted or to be contracted in the future by the debtor with Banco Popular de Puerto Rico. The Bank was entitled, by means of this document, to request from the debtor (Arenas, Inc.) the delivery of additional security to secure the payment of existing obligations. The document also states that if additional

security is requested and not delivered, the creditor (Banco Popular) is entitled to request the full payment of all debts and obligations, regardless of the time agreed upon for payment.

There is no real controversy between the parties as to the validity of the mortgages created on April 26, 1962 and February 5, 1963. These two mortgages were duly recorded in the Registry of Property and were validly issued and delivered to Banco Popular, to secure the loans that were to be granted and those already granted to Arenas, Inc. The real controversy involves the $2,000,000.00 mortgage note executed on December 20, 1963. This obligation was signed or issued by Vigdor Schreibman as President of Las Colinas, Inc., which was the surviving corporation in the merger of Las Colinas, Inc., Arenas, Inc., Ceiba Corporation and Eastern Construction Corporation. The mortgage which secured the payment of the $2,000,000.00 note was executed by Mr. Vigdor Schreibman, as President of Las Colinas, Inc. According to the certificates of resolutions approved by the Boards of Directors of Arenas, Inc. and of Las Colinas, Inc., there is no doubt that Mr. Schreibman was authorized, among other things, on behalf of the corporation, to sign, execute, assign, pledge and deliver, or in any other manner transfer to the Bank, as security for money borrowed or as security for any documents or accounts assigned, such contracts, promissory notes, mortgages and pledges as might be required by the Bank. He was also authorized to execute and deliver such additional securities as the Bank from time to time required in order to maintain an adequate margin of security for all loans. Besides, Mr. Schreibman's actions at the time he issued the $2,000,000.00 note, executed the mortgage to secure said note and delivered both documents as pledge to Banco Popular, were approved and consented to by almost all the direc-

tors of Las Colinas, Inc., some of them, the majority, by signing written consents on December 20, 1963, and others by telephone. Under these circumstances, we conclude that Mr. Schreibman acted with full authority at the time he issued and delivered to Banco Popular the $2,000,000.00 mortgage note, which authority he now contests.

Las Colinas, Inc. issued on February 4, 1963 a mortgage note in the amount of $750,000.00. Payment of this note was secured by a mortgage constituted by Deed Number 25, executed on February 4, 1963 before Notary Edilberto Berrios Dávila. Banco Popular has never attempted to foreclose this mortgage, although it still has the mortgage note in its possession. The land encumbered by or subject to this mortgage was the rest of the land which was part of the project, although no development or construction of houses was ever started on this land. This land is composed of several tracts of land or parcels, and each of them was subject to a mortgage securing the payment of the purchase price owed.

Banco Popular requested additional security, for the reason that since before December 1963 it had security only in the amount of $1,000,000.00, which was less than the total loans advanced by it to Debtors. At that time, Banco Popular requested that another mortgage be constituted on the land under development, since it represented the best security. Las Colinas, Inc. executed the $2,000,000.00 mortgage, which exceeded the actual debt, because at that time Las Colinas, Inc. was requesting another additional line of credit, which was the subject of negotiations between the parties. There is no evidence that the parties ever reached an agreement as to this new request for an additional line of credit. The fact that Banco Popular received the $2,000,000.00 mortgage note on or about the time that the negotiations for the new request took place cannot

be considered as proof of the existence of an agreement. The Bank had received a $750,000.00 mortgage note which it considered was not the best security as the note was secured by a mortgage of several undeveloped and encumbered parcels of land. The Bank preferred to have the additional mortgage security on land which was being developed and where the amounts advanced by it were expended. It is an uncontroverted fact that the $2,000,000.00 mortgage note exceeded the actual debt, but as has been already stated, Las Colinas, Inc. had requested additional sums of money and at the time such request was being considered and discussed by the parties, it seemed practical and logical to issue and deliver a mortgage note in excess of the debt which could serve as security in case the request for additional financing was approved by the Bank.

Las Colinas, Inc., Arenas, Inc., Ceiba Corporation and Eastern Construction Corporation were merged, the resulting corporation being Las Colinas, Inc. The consolidation agreement was presented to the Registry of Property of Humacao, Puerto Rico, on November 8, 1963, as is conclusively shown by the Registry Certificate issued on February 3, 1964. The three (3) mortgage deeds were recorded and are still recorded at the Registry of Property of Humacao. Deed Number 53, executed on April 26, 1962 before Notary Rafael Baragaño Diez, was recorded at pages 108 and 85 of Volume 93 of Fajardo, parcels number 2974 and 2073; Deed Number 26, executed on February 5, 1963, before Notary Edilberto Berríos Dávila, was recorded at pages 108 and 87 of Volume 93 of Fajardo; and Deed Number 374, executed on December 20, 1963, before Notary Edilberto Berríos Dávila, was recorded at pages 102 and 88 of Volume 93 of Fajardo.

There is also a controversy as to the title Banco Popular has over a parcel of 196 cuerdas, formerly belonging to the

Debtors. This parcel was purchased by Banco Popular at a public sale, pursuant to the foreclosure of the mortgage encumbering said parcel. The mortgage foreclosure was initiated by the Penedo family, who was a mortgage lien creditor. Las Colinas, Inc. owed around $147,123.59 of principal to the Penedo family, said amount being the balance of the purchase price of the encumbered property. On several occasions, Las Colinas, Inc. had requested loans from Banco Popular in order to pay the mortgage, and Banco Popular refused to advance money for such purposes. On December 27, 1963, the Penedo family obtained judgment in its favor and against Las Colinas, Inc., and the public sale of the parcel was effected on March 24, 1964. Banco Popular appeared at this sale and offered through its attorney Rafael Baragaño Diez the sum of $179,000.00 which was the highest bid made. On March 25, 1964, the Marshal of the Superior Court of San Juan executed Deed Number 73 before Notary Garrard Harris and officially conveyed to Banco Popular, by this act, title over the 196-cuerda parcel. This deed was recorded at page 71 of Volume 93 of Fajardo, said recording as to property number 2972. Debtors in Possession argued before this Court that the property acquired by the Bank at the judicial sale had a value of more than twice the amount paid by the Bank; that the Bank's Board of Directors authorized some Bank officers to bid an amount of more than twice the amount paid by Banco Popular for the property; that the Bank had given assurances to Las Colinas, Inc. that the Bank was going to advance the funds necessary to pay the mortgage in order to prevent the foreclosure sale; and that Las Colinas relied upon these representations of the Bank and allowed the Bank to take title to Las Colinas' 196-cuerda parcel in its name. By reason of the foregoing, Debtors claim that Banco Popular should be considered a

constructive trustee of the property. This whole argument is based on alleged facts which we deem do not support such claim. This Court considers as established the fact that Banco Popular de Puerto Rico on several occasions informed several officers of Las Colinas, Inc. that the Bank was willing to reconvey the 196-cuerda parcel to Las Colinas, Inc. if Las Colinas paid back all the amounts owed by it to Banco Popular de Puerto Rico.

It should be mentioned that at the end of 1963 Las Colinas, Inc. was having economic hardships. Due to this circumstance and to delays in the development of the land and construction of houses, Section One of the project was never finished. Las Colinas, Inc. requested additional credits from Banco Popular and, as we stated before, prolonged negotiations and meetings were held by the two parties. This Court considers that it has not been established that Banco Popular ever agreed to go beyond the line of credit approved. All this brought the initiation of foreclosure proceedings by Banco Popular, which filed the same on July 6, 1964 at the Superior Court, Humacao Part. Banco Popular also recorded a Notice of Pending Suit (Lis Pendens) in the Registry of Property, at the time the foreclosure suit was filed. It was thereafter that Las Colinas, Inc. and Eastern Shore Development Corporation filed the Petition for Arrangement under Chapter XI of the Bankruptcy Act. This petition was filed on October 15, 1964.

Conclusions of Law

Obligations arising from contracts have legal force between the contracting parties, and must be fulfilled in accordance with the terms thereof. Article 1044 of the Civil Code, 1930 edition, 31 L.P.R.A. Sec. 2994[1]. Caribbean

[1] All references to the Civil Code are to the 1930 edition.

Industries, Inc. v. Camacho, 71 P.R.R. 726 (1950). When the lines of credit granted by Banco Popular to Arenas, Inc. and Las Colinas, Inc. were totally exhausted, and Las Colinas, Inc. was left with no other economic means to complete the work, sell the lots and the houses and pay back the loans to the Bank, the latter was entitled to demand payment of all the amounts owed. Payment of said amounts did not depend on the fulfillment of any obligation by the Bank. Neither the notes delivered as evidence of the debt nor the mortgage notes, pledge agreements and mortgage deeds, nor any other documents submitted in evidence conditioned the payment of the amounts owed to the fulfillment of any obligation by Banco Popular de Puerto Rico.

When notes are payable on demand, without any condition to the contrary, and this is the case of the notes that evidence the debt in this case, it is not necessary to demand payment to give rise to the maturity of the obligation. It is a general rule of law that a demand note is payable immediately on the date of its execution and that it is due upon delivery thereof, unless a contrary intention appears expressly or implicitly upon the face of the instrument. See, 71 A.L.R.2d 290, Sec. 3; 147 A.L.R. 1109, Sec. 13. In other words, a right of action against the maker of a demand note arises immediately upon delivery and no express demand is required to mature the note or as a prerequisite to such right of action, the commencement of a suit being sufficient demand for enforcement purposes. Bank of Nevada v. United States, 251 F.2d 820 (9th Cir. 1957); Brummagim v. Tallant, 29 Cal. 503; 71 A.L.R.2d 295 (1856); Articles 436 and 437 of the Commercial Code of Puerto Rico, 1932 edition, 19 L.P.R.A. Secs. 144 and 145. The notes, payment of which is claimed in this case by Banco Popular

de Puerto Rico, being payable on demand, were payable immediately on the date of their execution and delivery to Banco Popular, and no prior demand was required for their collection through judicial proceedings. Servera Silva v. Pedrosa, 43 P.R.R. 676 (1932). Banco Popular would have been estopped only if its right to demand payment would have been conditioned on its fulfillment of certain conditions, in the nature of reciprocal obligations. But that was clearly not the situation in this case. As was stated by the Supreme Court of Puerto Rico in Madera v. Madera, 49 P.R.R. 159 (1935), where an undertaking to pay a promissory note is not subject to the conditions contained in another contract in which the promissory note and mortgage originated, the nonperformance of these conditions cannot serve as an excuse for the failure to comply with the obligations under the promissory note, nor can it serve as a defense to an action brought to foreclose the mortgage securing it. See also, Article 1053 of the Civil Code, 31 L.P.R.A. Sec. 3017.

The three bearer mortgage notes delivered to Banco Popular as collateral security or pledge secured the payment of the principal amount owed, as well as the interest that such obligations accrued, and the costs, expenses, disbursements and attorneys' fees stipulated in each note. According to the terms of the General Pledge Agreements subscribed by Arenas, Inc. and delivered to Banco Popular de Puerto Rico, the securities delivered as collateral or pledge secured payment in a general and broad sense of all the debts and obligations of debtors in favor of Banco Popular de Puerto Rico. Besides the fact that we deem that the term obligation as it is used in the pledge agreement, refers to and includes instruments or documents that represent or evidence sums of money payable by the

person that issues them, and that in the notes that evidence the debt, payment of which is claimed, the parties stipulated the payment of principal, interest thereon, costs, expenses, disbursements and attorneys' fees, we conclusively understand that the provisions contained in Articles 1111 and 1122 of the Civil Code, 31 L.P.R.A. Secs. 3161 and 3172, are applicable. Both sections deal with the payment of debts. Article 1111 establishes that a debt shall not be considered as paid "until the full amount of the thing has been delivered, or the prestation of which the obligation consisted has been made." On the other hand, Article 1122 refers to the judicial or extrajudicial expenses arising from the collection of debts. In this case, the parties stipulated in each of the 83 notes and in each of the 3 bearer mortgage notes the principal sums, the interest thereon, cost, expenses, disbursements and attorneys' fees in the event of recourse to the courts in order to collect the amounts owed. Debtors' obligation consisted in the payment of all these amounts mentioned above and stipulated in the notes, and the securities given also extended to all these amounts that are part of the whole debt. Article 1122 of the Civil Code establishes, as to the expenses incurred by the creditor in the judicial collection of his credit, that the court "shall decide in accordance with the law of civil procedure." However, although this refers to Rule 44 of the Rules of Civil Procedure of Puerto Rico, which regulates the award of costs and attorneys' fees in civil cases, Article 1122 and Rule 44 only apply in cases in which there is no written stipulation to the contrary as to these matters. Where, as in the case before us, the promissory and mortgage notes expressly contain a stipulation as to costs, expenses and attorneys' fees, this contractual stipulation has legal force between the contracting parties. See, Clausells v. Salas, 51 P.R.R. 87

(1937); Cintrón & Aboy v. Solá, 22 P.R.R. 245 (1915). In cases where there is a stipulation in the instrument, the award of costs, expenses and attorneys' fees is not discretionary of the court, but are awarded as a matter of contract law. Chausells v. Salas, supra.

A contract without consideration is wholly void and nonexistent and has no effect whatsoever. Article 1227, Civil Code, 1930 edition, 31 L.P.R.A. Sec. 3432, Hull-Dobbs. Co. v. Superior Court, 81 P.R.R. 214 (1959); Soto v. Feliciano, 80 P.R.R. 595 (1958); Monserrate v. Lopes, 80 P.R.R. 476 (1958); Guzmán v. Guzmán, 78 P.R.R. 640 (1955). But the fact that no money or property was received by the debtor from the creditor at the time an obligation is subscribed by the former, does not preclude the existence of consideration in said note. Cámara Insular v. Santiago, 83 P.R.R. 574 (1961); National City Bank v. Martinez, 41 P.R.R. 162 (1930). Any detriment to the opposite party is a valuable consideration. Bennett v. Boschetti, 31 P.R.R. 809 (1923); National City Bank v. Martinez, supra, at page 163. As a matter of law, where a promissory note is subscribed by a debtor in substitution for other prior obligations, the fact that no money or property is received from the creditor by virtue of the obligation thus subscribed, does not preclude the existence of consideration in said note, and a debtor cannot avoid liability by claiming that no benefit was received. See, Cámara Insular v. Santiago, supra. The juridical relationship between Banco Popular de Puerto Rico and Arenas, Inc. was contractually established in the General Pledge Agreements, by which Arenas, Inc., among other things, assumed the obligation of delivering additional security for the payment of the debt or else all obligations became due automatically. If no additional security would have been delivered it would have resulted not only

in detriment to Banco Popular de Puerto Rico, which could have thought it did not have sufficient security, but in detriment to the debtor, who was subject to pay the whole debt to Banco Popular.

Furthermore, even though the consideration is not expressed in a contract, it is presumed that it exists and that it is licit, unless the debtor proves the contrary. Article 1229, Civil Code, 31 L.P.R.A. Sec. 3434. There was evidence presented as to the fact that Las Colinas, Inc., after delivering the $2,000,000.00 bearer mortgage note, did not receive any sum of money, except those amounts necessary to pay notarial fees and recordation expenses of the $2,000,000.00 mortgage deed. But, assuming, arguendo, that the amounts referred to above, and the additional advance of approximately $26,000.00 received by Las Colinas, Inc. after it delivered such security, do not constitute consideration, the uncontroverted fact still remains that the prior loans were made under a pledge contract in which the delivery of additional security was stipulated, or else debtor was bound to pay the debt in full. Therefore, we must conclude that Debtors did not meet the burden of proving lack of consideration, and the presumption of Article 1229 should be given full force and effect.

A creditor who holds in pledge, as collateral security, a promissory note secured by mortgage need not become the absolute owner of the note or the mortgage in order to institute foreclosure proceedings. A creditor has sufficient interest in a promissory note pledged to him as collateral security to prosecute an action in his own name to enforce the collection thereof. Title passes to him at the time possession is transferred to him and he is entitled to claim through judicial proceedings payment of the obligation and to foreclose the mortgage, as well. All these

rules of law were established by the Supreme Court of Puerto Rico in Acevedo v. Treasurer, 52 P.R.R. 446 (1938), after construing Article 1768 of the Civil Code, 31 L.P.R.A. Sec. 5027, which reads as follows:

> As long as the thing given in pledge is not taken by eminent domain, the debtor continues to be the owner thereof.
>
> Nevertheless, the creditor may exercise the actions which pertain to the owner of the thing pledged, in order to reclaim or defend it against a third person.

It is true that the nominal value of the mortgage notes held as collateral security or pledge exceeds the actual debt. But Section 44 of the Uniform Negotiable Instruments Act of Puerto Rico, 19 L.P.R.A. Sec. 44, solves this situation by establishing that:

> Where the holder has a lien on the instrument, arising either from contract or by implication of law, he is deemed a holder for value to the extent of his lien.

Where a note is transferred as collateral security for the payment of a debt, it is equivalent to the establishment of a lien on the instrument, pursuant to Section 44 quoted above, and the holder may recover judicially on the note to the extent of its lien. Sorrentini & Company v. Méndez, 76 P.R.R. 646 (1954).

In addition to what has been stated before, that the $2,000,000.00 mortgage note secured, together with the other two mortgage notes, the payment of the debt claimed by Banco Popular de Puerto Rico, and that said note is liened in favor of Banco Popular de Puerto Rico, it must be noted that, in Puerto Rico, as a matter of local law, the holder of a note who takes it for an already existing debt

is a holder for value received to the extent of the debt, even though such taking is merely as collateral security. See, Sorrentini & Company v. Méndez, supra; Cf. Section 60(b) of the Bankruptcy Act, 11 U.S.C. § 96(b).

So far, we have set forth, in general, the legal situation as to Banco Popular's claim. Debtors in Possession made several contentions as to the validity of such claim and also set forth several defenses against the Bank's claim. We shall consider all of these contentions and defenses as they were stated in Debtors' First Amended Consolidated Application for Relief Against Banco Popular de Puerto Rico, filed on February 23, 1968.

We have already found that, as a matter of fact, Banco Popular never agreed to advance all of the funds needed to pay the entire cost of development and construction of houses. This Court is convinced that Banco Popular's commitment was limited to the $1,750,000.00 line of credit, and that it was not willing to undertake the financing of additional work unless the work in process on the First Section of the Las Colinas Project was successfully concluded. The Court is not convinced that a banking institution will commit itself to the financing agreements alleged by Debtors. At most, evidence was contadictory in this regard, and the only written evidence in this respect points to the limitation of Banco Popular's commitments. First, the Bank's internal memoranda clearly established that a maximum line of credit of $1,750,000.00 was in effect, and there was no written evidence that this was ever changed. Although Las Colinas, Inc., and Banco Popular held several meetings regarding the request for money in excess of the line of credit in effect, we cannot conclude, either as a matter of fact or as a matter of law, that the Bank ever agreed to grant this request. This being the juridical relation between the parties, the Court cannot make any

determination as to the breach of agreements by Banco Popular. Article 1042 of the Civil Code, 31 L.P.R.A. Sec. 2992, establishes the basic rule that obligations are "created by law, by contracts, by quasi contracts, and by illicit acts and omissions or by those in which any kind of fault or negligence occurs." Article 1043 of the Civil Code, 31 L.P.R.A. Sec. 2993, provides that "obligations arising from law are not presumed," and that obligations arising from contracts should be based on contracts, the existence of which must be established. The burden of proof rests on the party demanding compliance with an obligation to show the existence of the same and, if said party fails to prove his case, the other party should be discharged from liability. See, Article 1168 of the Civil Code, 31 L.P.R.A. Sec. 3261; Martinez v. Garcia, 18 P.R.R. 2, 4 (1912); Olivieri v. J. Tornabells & Co., 7 P.R.R. 92 (1904). Therefore, in the absence of contractual obligations, there can be no breach of agreement which could be imputed to Banco Popular de Puerto Rico.

Debtors also allege that the repeated assurance of Banco Popular as to its financial commitments toward them amounted to a deliberate series of false representations "designed to mislead Las Colinas, Inc., and thereby prevent it from seeking the benefit of Chapter XI of the Bankruptcy Act within four months from the date on which the Bank received and recorded the [$2,000,000.00] Bearer Mortgage." They claim that the Bank's conduct was fraudulent and that by virtue of such conduct, Debtors have suffered actual damages in the sum of approximately $3,600,000.00.

Article 1054 of the Civil Code, 31 L.P.R.A. Sec. 3018, establishes the general rule that those who "in fulfilling their obligations are guilty of fraud * * * and those who in any manner whatsoever act in contravention of the stipulations of the same, shall be subject to indemnity

for the losses and damages caused thereby." As we have already stated, in the absence of obligations contracted by a party, there is no doubt that Banco Popular could not be charged with fraud in "fulfilling" its obligations.

Besides, there are other legal obstacles to such adjudication. First, there is the legal presumption that everybody acts in good faith and that private transactions are conducted in good faith and according to law. Whoever alleges fraud has to destroy these presumptions. This Court is of the opinion that the presumption of good faith was not destroyed by Debtors. There is no certainty that Banco Popular made false representations in order to defraud Las Colinas, Inc. At least, four elements should be established in a charge of fraud:

1. the intent to defraud
2. reliance on the fraudulent acts
3. the false representations used to consummate the fraud
4. that the fraud was consummated by virtue of such representations

See, Chanin v. Chevrolet Motor Co., 89 F.2d 889, 111 A.L.R. 1235 (7th Cir. 1937); South Branch Lumber Co. v. Ott, 142 U.S. 622, 12 S.Ct. 318, 35 L.Ed. 1136 (1892); Cooper v. Schlesinger, 111 U.S. 148, 4 S.Ct. 360, 28 L.Ed. 382 (1884); 37 Am.Jr.2d Fraud and Deceit, Secs. 188, 434 and 435; Rubio Meléndez v. Examining Board, 47 P.R.R. 880 (1934); S. Canet & Co. v. N. Santini, 44 P.R.R. 78 (1932).

Since the presumption is in favor of the good faith and honesty and against fraud, the party who alleges fraud must prove its existence with uncontroverted and

unchallengeable facts. Bamberger v. Schoolfield, 160 U.S. 149, 16 S.Ct. 225,40 L.Ed. 374 (1895); Continental Casualty Co. v. First National Bank, 116 F.2d 885, 135 A.L.R. 1141 (5th Cir. 1941); In re Black Ranches, Inc., 362 F.2d 19 (8th Cir. 1966); Monclova v. Financial Credit Corp., 83 P.R.R. 742 (1961); Serrano v. Torres, 61 P.R.R. 157 (1942); The Texas Co. v. Estrada, 50 P.R.R. 709 (1936). The fact that this Court may act as a court of equity does not change the above mentioned rule. Hager v. Thomson, 66 U.S. (1 Black) 80, 17 L.Ed. 41 (1861); Hempstead v. Johnston, 18 Ark. 123 (1856); Southern Development Co. of Nevada v. Silva, 125 U.S. 247; 8 S.Ct. 881, 31 L.Ed. 678 (1888). Besides the burden of proof, the party who alleges fraud must produce evidence which is *strong, clear, unchallengeable, convincing and conclusive, since a mere preponderance of the evidence is not sufficient to establish the existence of fraud in our jurisdiction.* See, Monclova v. Financial Credit Corp., 83 P.R.R. 742 (1961); Calzado et al. v. Carrero et al., 15 P.R.R. 340 (1909); Ana María Sugar Co. v. Castro et al., 28 P.R.R. 225 (1920); Núñez v. Rodríguez, 51 P.R.R. 622 (1937); Mario Mercado e Hijos v. Olivieri, 60 P.R.R. 855 (1942); Lundstrom v. Radio Corporation of America, 17 Utah 2d 114, 405 P.2d 339, 14 A.L.R.3d 1058 (1965); Master v. Master, 223 Md. 618, 166 A.2d 251 (1960); Buzard v. Griffin, 89 Ariz. 42, 358 P.2d 155 (1961). Mere conclusions, conjectures, and suppositions or suspicions are not of themselves sufficient to substantiate an allegation of fraud. Serrano v. Torres, supra. Where one party alleges a conspiracy to defraud, until such conspiracy is proved, the other parties are subject to no more suspicion than would any other defendants called as witnesses, and their testimony, although interested, must be presumed to be true until duly discredited. Ana María Sugar Co. v. Castro, supra; In re Jersey Materials Co., 50 F.Supp. 428 (E.D.N.J.1943). Apparently, Debtors pretend

that we can infer fraud from the fact that Las Colinas, Inc., had to request the benefit of the rehabilitation proceedings of Chapter XI of the Bankruptcy Act. However, there is no doubt that Las Colinas' failure and weak financial condition arose from the facts that it had no working capital and was unable to complete the works on time. See, Monclova v. Financial Credit Corp., supra.

This Court concludes that Debtors did not destroy the presumption of good faith that operates against a charge of fraud. There was contradicted and controverted evidence as to the alleged commitments and obligations. We have already concluded that Banco Popular only committed itself to lend up to $1,750,000.00 and that it actually lent in excess of that amount. If this is an established fact, and we conclude it is, it follows that no representations were made by Banco Popular designed to mislead, or with intent to defraud the Debtors. If the facts are susceptible of a natural and probable explanation which is compatible with the good faith and honesty of the parties, fraud is not established. Calzado, et. al. v. Carrero, et al., 15 P.R.R. 340 (1909); Feliciano v. P. Cedeño, 78 P.R.R. 37 (1955).

Debtors in Possession allege that each mortgage was recorded as to more than one parcel of real property without recording a determination of the amount of actual debt for which each property was responsible. It is argued that since actual debt was less than the total amount of mortgage responsibility, the records at the Registry of Property should have shown the amount of actual debt for which each property was responsible. This argument is allegedly based on the provisions of Article 119 of the Mortgage Law and Article 164 of the Mortgage Regulations, which state as follows:

> When a number of estates are mortgaged at the same time for a single credit, *the amount or part of the lien*

> *to be borne by each* shall be determined * * * (30 L.P.R.A. Sec. 215—Emphasis supplied).
>
> Registrars shall not record any mortgage on different properties subject to the same obligation, unless by agreement between the parties or by a judicial order in a proper case, the amount which each estate is to secure shall be determined. (30 L.P.R.A. Sec. 1085).

It is obvious that Debtors based their arguments on an erroneous construction of Articles 119 of the Law and 164 of the Regulations. Both articles refer to "*the lien to be borne by each*" estate and to the amount of the mortgage debt which each estate is to secure. In this case, both articles were complied with, since in all mortgages the amount of the lien to be borne by each estate was expressly determined in the mortgage deeds. There is no indication in any of the two above mentioned articles that when the mortgage lien is greater than the actual debt a determination should be made as to the responsibility of each estate with regard to the actual debt. As a matter of law, the Mortgage Law expressly rejects Debtors' argument by providing in Article 122 that:

> The mortgage shall continue intact as long as it is not cancelled *on all the property mortgaged, even though the obligation secured be reduced* * * (30 L.P.R.A. Sec. 218—Emphasis supplied).

We must emphasize that in the above quoted article the Mortgage Law makes a distinction between mortgage lien and obligation secured, and provides that the obligation secured could be reduced, but still the mortgage lien shall continue intact. Article 124 of the Mortgage Law regulates the situation in which a mortgage created for the security of a debt is divided among a number of estates, and an

amount equivalent to the lien encumbering one of said estates is paid. This article provides that the "person interested may apply for the *partial* cancellation of the mortgage as to the said estate." (Emphasis supplied.) If release from the mortgage of one or the other of the mortgaged estates may be obtained, because the amount paid exceeds the lien on one as well as the other estate the debtor shall select the one which is to be freed from encumbrance. See, 30 L.P.R.A. Sec. 220, and Muriente v. Yumet, 58 P.R.R. 619 (1941). 2 Fernando Campuzano y Horma, Legislación Hipotecaria, pp. 108-116 (2d ed.). The fact that the mortgage lien is greater than the actual debt does not make the mortgage null. The mortgage creditor is only entitled to collect the exact amount owed as capital and interest. See, article 169 of the Mortgage Regulations, 30 L.P.R.A. Sec. 1090; Delgado v. Banco Popular, 55 P.R.R. 912 (1940). We cannot forget that in this case the creditor, Banco Popular de Puerto Rico, is the holder of bearer mortgage notes. A mortgage which secures a promissory note payable to the bearer is not a bilateral contract when it is made, nor can it be considered such until the promissory note is negotiated. It is not until the debtor receives the loan and the creditor accepts the promissory note that the mortgage contract becomes valid and binding on both contracting parties. Morales v. Registrar, 54 P.R.R. 520 (1939). It is at the time the promissory note is delivered that the mortgage is perfected and the amounts loaned or advanced under a contract become secured up to the amount of the mortgage. The extent of the mortgage becomes at such time the amount of the debt, unless the debt be greater than the amount of the mortgage.

Debtors refer to the case of Crédito y Ahorro Ponceño v. Registrar, 30 P.R.R. 131 (1922), which explains the reason behind Articles 119 and 164. This Court is of the

opinion that that case is not applicable to our situation since in our case the amount which each estate is to secure was determined in the mortgage deeds. In this case we cannot say that a "subsidiary mortgage" was created, since each estate did not secure the whole principal, but only part thereof. The evils pointed out in the *Crédito y Ahorro Ponceño* case are not present in this case, since debtors still have recourse to Article 124 of the Mortgage Law and could have obtained the partial cancellation of the mortgage as to any of the estates if the amounts secured by any said estate had been paid. This course of action was not possible in the *Crédito y Ahorro Ponceño* case where each estate secured the part of the debt and also the full amount of the debt through the "subsidiary mortgage."

Debtors also argue that Article 12 of the Mortgage Law was violated. This Article reads as follows:

> The entries of mortgages securing debts shall in every case set forth the amount of the obligation and of the interest secured if any; and in the absence of such statement as to interest none shall be considered secured by the mortgage, according to the provisions of this subtitle. (30 L.P.R.A. Sec. 37)

This argument has no factual basis. First, the above mentioned article is of an administrative character, and only establishes the circumstances a mortgage entry should contain. Furthermore, in this case all the mortgage deeds set forth the amount of the obligation and of the interest secured, as well as the amount of other items secured.

Debtors next argue that Articles 9, 30 and 32 (30 L.P.R.A. Secs. 34, 55 and 57, respectively) were also violated, and that, consequently, the mortgages are void as to third-party creditors. Debtors erroneously assert that

the records in the Registry of Property should have set forth the facts that the mortgages were "constituted to secure conditional future obligations which might or might not come into existence depending upon the occurrence of future events." The parties in this case did not contract on the basis of conditional obligations or of obligations which might or might not come into existence. The securities, issued by Debtors and owned and held by them, were delivered to guarantee payment to Banco Popular of financial accommodations agreed upon. The notes and the mortgages were not instruments made to Banco Popular. They were Debtors' instruments, under Debtors' *ex parte* contracts, to be used by them as they might choose. They chose to use them as security for financial accommodations agreed upon with Banco Popular. Las Colinas' duty or obligation to pay back its debt to Banco Popular did not depend on any resolutory or suspensive condition. Article 1066 of the Civil Code, 31 L.P.R.A. Sec. 3041, governs this situation and clearly establishes in its first paragraph that:

> Every obligation, the fulfillment of which should not depend upon a future or uncertain event or upon a past event, unknown to the parties in interest, shall be immediately demandable.

It cannot be argued that the Bank's right to collect the money owed to it depended on certain conditions. At the time it advanced the money, the Bank acquired the right to claim its payment and debtor became bound to return to the Bank an equal amount of money and the interest thereon. See Articles 1644 and 1646, 31 L.P.R.A. Secs. 4571 and 4573; Espino v. Frías, 7 P.R.R. 541 (1904). It is a well known rule of law that in conditional obligations, the acquisition of rights, as well as the extinction or loss of those already acquired, shall depend upon the event con-

stituting the condition. Article 1067 of the Civil Code, 31 L.P.R.A. Sec. 3042. In our case the Bank's right did not depend on any condition. In Amy v. Registrar of Property, 21 P.R.R. 114 (1914), the Supreme Court of Puerto Rico clearly established the differences between the maturity and the conditions of obligations, and both must be distinguished in order not to confuse a deferred obligation with a conditional one. It then was stated that the "condition" is an uncertain event, whereas the *term* is an event which is bound to take place, even though it is not known when. Thus, the basic difference is that the condition may be such that the obligatory relation may or may not have effect, whereas the *term* merely places a limitation upon the time when the contractual relation shall take effect. 21 P.R.R. 114, 118 et seq. The essential element of a conditional obligation is the uncertainty of its *occurrence*. 8 Manresa, Comentarios al Código Civil Español, Part 1, pp. 309, 301 to 321 (1950 ed.); 1 Puig Brutau, Fundamentos de Derecho Civil, Part 2, pp. 118 to 148; 4 Puig Peña Tratado deDerecho Civil, Part 1, p. 118; 3 José Castán Tobeñas, Derecho Civil Español, Común y Foral, pp. 143 to 156 (10th ed., 1967).

The cases of Gaztambide v. Heirs of Ortiz, 70 P.R.R. 338 (1949); Galiñanes Honos. v. Registrar, 65 P.R.R. 541 (1946); Ortiz v. Registrar, 16 P.R.R. 643 (1910); and Crédito y Ahorro Ponceño v. Registrar, 30 P.R.R. 131 (1922), are not applicable to this case, since in all of these cases the mortgage deeds in one way or another did not establish the part of the lien to be borne by each separate estate, while in this case all of the mortgage deeds made such determination, making possible the partial liberation provided for in Article 124 of the Mortgage Law, 30 L.P.R.A. Sec. 220. The reason why Article 119 of the Mortgage Law requires that the mortgage responsibility be distributed among several estates is that the creditor

cannot have any recovery to the prejudice of third persons, in excess of the amount for which each estate may be respectively encumbered, together with the interest thereon. Article 119 of the Mortgage Law (30 L.P.R.A. Sec. 215). If the actual debt is less than the amount to be borne by each of the estates mortgaged, it cannot be argued that such circumstance is prejudicial to third persons, since the creditor is only entitled to collect up to the amount actually owed to him.

In this case, the Bank asserts the right of mortgage foreclosure on the fact that it is a pledgee of bearer notes secured by mortgages. The pledges of the First Arenas $500,000.00 Bearer Note and the Second Arenas $500,000.00 Bearer Note were made as a result of the provisions of the Arenas' General Pledge Agreements (Exhibits 41 and 42). The Bank also claims that the Las Colinas $2,000,000.00 Bearer Note was also made under the provisions of the Pledge Agreements executed by Arenas. Debtors in Possession claim that the pledges asserted by the Bank are not valid because they were invalid against third parties under the laws of Puerto Rico. Debtors state that the pledges are not valid as to third parties by reason of Article 1764 of the Civil Code, 31 L.P.R.A. Sec. 5023, which reads as follows:

> A pledge shall not be effective against a third person, when evidence of its date is not shown by authentic documents.

"Authentic document" is any document executed or subscribed before a notary public or that qualifies as an affidavit within the provisions of the law. Bonilla v. Santiago, 30 P.R.R. 229 (1922), 4 L.P.R.A. 887; Ramos Mimoso v. Superior Court, 93 P.R.R., 93 D.P.R. 551 (1966).

Besides the requisites mentioned in Article 1756 of the

Civil Code (31 L.P.R.A. Sec. 5001), it is necessary, in order to constitute the contract of pledge, that the pledge should be placed in possession of the creditor or of that of a third person, by mutual consent. Art. 1762 of the Civil Code, 31 L.P.R.A. Sec. 5021. In other words, once the contract complies with the requisites mentioned in Article 1756 and the pledge is in possession of the creditor, the contract is perfected as between the contracting parties. This is why a pledge is a real contract. See, 12 Manresa, Código Civil Español, pp. 417, 418-422 (1951). In order to prevent frauds, the Civil Code establishes that a pledge shall not be effective against a third person, "when evidence of its date is not shown by authentic documents." Article 1764, 31 L.P.R.A. Sec. 5023. As long as no third person attaches or in any other way obtains a lien on the thing pledged, the contract of pledge is absolutely valid between the contracting parties. In our case there is no question that the promissory notes were legally and duly delivered to Banco Popular, and the Bank had the notes in its possession at the time it initiated the foreclosure proceedings at the Humacao Court, at which time it also caused a *lis pendens* to be entered in the records of the properties mortgaged. The Bank had the General Pledge Agreements subscribed by Arenas, Inc. and these documents were "authentic documents," since each of them had an affidavit accrediting that both were signed before a notary public. We must then try to answer the following question: What is the date that should be shown by authentic documents? There is no doubt that Article 1764 does not refer to the date the pledge is delivered, but to the date the pledge contract is constituted. See, 25 Enciclopedia Jurídica Española, Prenda, p. 387; Manresa, op. cit., p. 432. On the other hand, the authentic document referred to in Article 1764 does not have to

contain any information as to other circumstances of the contract, but its only purpose is to evidence the date the contract is constituted. See, Manresa, op. cit., p. 432. The fact that some of the mortgage notes were delivered to the Bank after the General Pledge Agreements were authenticated before a notary public does not make the pledges defective as against third persons, since the pledge agreements evidence the date the pledges were constituted.

In any event, the jurisprudence admits that if the date has become certain by another means, that suffices. 2 Planiol, Traité Elementaire de Droit Civil, Part 2, No. 2419, p. 373. We should not confuse the facts as they occurred in this case. Several months before the Petition for Arrangement was filed by Debtors, Banco Popular de Puerto Rico had caused a *lis pendens* to be entered in the records of the mortgaged properties in the Registry of Property. Banco Popular de Puerto Rico had initiated a judicial proceeding claiming the status of a pledge creditor, indubitably establishing the existence of a debt. The Bank had at that time the possession of the mortgage notes pledged. After this date, a third person could not obtain a better right on these notes. At the time the Petition for Arrangement was filed, the pledges were effective *erga omnes*, since long before the filing of the petition there was no possibility that a third person could obtain a senior lien or preferred lien on these notes. In a situation like this, we might say that Article 1764 is not applicable since the possibility of an *a posteriori* fraudulent claim, which Article 1764 tries to prevent, is no longer possible. At the time foreclosure proceedings are initiated, the existence of the claim or obligation is indubitably revealed to the world.

We have stated before that Arenas, Inc., Ceiba Corporation and Eastern Construction Corporation were merged

into Las Colinas, Inc. The Consolidation Agreement was presented to the Registry of Property on November 8, 1963. This Court had before it a Certificate issued by the Secretary of State of Puerto Rico in which it is stated that the Consolidation and Merger Agreement was filed in the Department of State and that all legal requirements were complied with, by virtue of which the predecessor corporations were dissolved, Las Colinas, Inc. assuming all the rights, contracts and obligations, including title to real estate, of the dissolved corporations. It may be argued that the agreement filed in the Registry of Property regarding the merger had not yet been recorded in the office of the Department of State. However, recordation of an agreement of merger or consolidation does not create rights or obligations. The agreement itself does that. Recordation is merely the evidence that the agreement was entered into. The agreement was later recorded, and the evidence of recordation was brought before this Court. We cannot now say that title to land acquired by Las Colinas, Inc. under an agreement is not valid because at the time title was claimed and asserted the agreement pursuant to which title had been acquired had not been recorded. Be that as it may, the agreement of merger or consolidation was later recorded and there can be no question that whatever defects might have existed were cured, and that title to the land was vested in Las Colinas, Inc. since the agreement, which was later recorded, was executed by the parties to the merger or consolidation.

It is a well established rule of law that in the case of a consolidation or merger, the consolidated or absorbing corporation becomes vested with whatever title or interests the old corporations had in the property, without further act or deed. This transfer is made by operation of law. See, Section 903 of the Corporation Law (14 L.P.R.A.

Sec. 1903); 16 Fletcher, Cyclopedia of the Law of Private Corporations, Secs. 7088, 7102 et seq. (1961); American Cement Corporation v. Dunetz Bros. Inc., 47 Misc.2d 747, 263 N.Y.S.2d 119 (1965); First Wisconsin Trust Co. v. Johnson, 173 Wis. 564, 181 N.W. 828 (1921). Upon the consolidation or merger, "all rights, privileges, powers, and franchises as well of a public as of a private nature, and being subject to all restrictions, disabilities and duties of each of such corporations so consolidated or merged," and "all debts due, liabilities and duties of the respective constituent corporations shall attach to the resulting or surviving corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it." See, Section 903 of the Corporation Law (14 L.P.R.A. Sec. 1903), Fletcher, op. cit., Sec. 7102, et seq. By virtue of these rules of law, Las Colinas, Inc. became bound under the Pledge Agreements subscribed by Arenas, Inc., and the contractual obligations created under the provisions of said contracts can be enforced against Las Colinas, Inc. to the same extent as if said obligations had been incurred or contracted by it. See, Drug, Inc. v. Hunt, 5 W.W.Harr., 339, 35 Del. 339, 168 A. 87 (1933); State ex rel. v. American Bonding & Casualty Co., 213 Iowa 200, 238 N.W. 726 (1931).

As to the recordation of the $2,000,000.00 mortgage executed by Las Colinas, Debtors allege that said mortgage is void by virtue of the provisions of Article 126 of the Mortgage Law (30 L.P.R.A. Sec. 222). It is alleged that Las Colinas, Inc. was not the owner of record of the property encumbered at the time of the execution and presentation of the mortgage deed, and that such mortgage is void notwithstanding the fact that Las Colinas, Inc. had become the owner thereof. It is true that at the time of the execution of the deed, Las Colinas, Inc.

was not the *owner of record* of the properties encumbered. However, the mortgage deed was presented to the Registry together with the Consolidation or Merger Agreement and supplementary documents. Article 126 of the Mortgage Law reads as follows:

> A mortgage constituted by a person who according to the registry has no right so to do, shall not be valid, even though the mortgagor shall subsequently acquire such right.

Although a literal reading of Article 126 tends to support Debtors' contention, it is obvious that once again Debtors have failed to consider the cases that have construed Article 126. Galindo y Escosura, two eminent authorities in the field of Spanish Mortgage Law, clearly set forth the construction to be given to Article 126. They have made a thorough analysis of court rulings construing Article 126, and the relation of said article to other articles of the Mortgage Law. And they state that Article 126 should not be considered by itself since there are other provisions that should be harmonized with it, and that, for this reason, the scope of Article 126 must be restricted. As the basis for this argument, the authors cite certain rulings issued by the Administrative Courts of Spain (Dirección de los Registros), which have concluded that by virtue of Article 20 of the Mortgage Law[2] the owner of a property could legally encumber it before he

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[2] In order to permit the record of or entry of deeds * * * encumbering the ownership * * * of real property or property rights, the interest of the person executing it or of the person in whose name the * * * encumbrance is made must first appear of record.

Registrars shall refuse to record such deeds until this requisite shall have been complied with * * * (30 L.P.R.A. Sec. 45. Emphasis supplied.)

became the owner of record. See, 3 Galindo y Escosura, Comentarios a la Legislación Hipotecaria de España, pp. 275 to 278 (4th ed., 1903); Resolución de la Dirección General de los Registros de España, dated October 1, 1874; Resolución, dated May 23, 1874. Considering the construction given to Article 126 in Puerto Rico, it would be convenient to quote a paragraph from the treatise written by Luis Muñoz Morales:

> But this provision of the Mortgage Law [Art. 126] cannot be construed literally, since all that the Civil Code requires is that the property or right to be mortgaged must belong to the person who mortgages it, even though he has not yet become the owner of record * * * (2 Lecciones de Derecho Hipotecario, p. 46 (1946).

There is no basis for Debtors' contention that Article 126 should be construed literally and independently of all other provisions of the Mortgage Law. Galindo's and Morales' position has not only been followed by the courts and administrative bodies of Spain[3] but it has been expressly followed by the Supreme Court of Puerto Rico. In the case of Amy v. Registrar, 21 P.R.R. 114 (1914), the Supreme Court ruled that a mortgage deed executed by a person who was not the owner of record at the time of execution, was valid and was recordable, subject to the condition that, prior to its recordation, the property be recorded in the name of the mortgagor. See also, González v. Registrar, 14 P.R.R. 255 (1908); Dávila v. Regis-

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[3] It is most revealing that the Spanish Mortgage Law of 1909 no longer has an article equivalent to the present Art. 126 of Puerto Rico, avoiding in this way the confusion created by said article. See 4 Morell y Terry, Comentarios a la Legislación Hipotecaria, p. 43 (1918).

trar, 20 P.R.R. 143 (1914). Therefore, the $2,000,000.00 mortgage was valid since it was executed by the legal owner according to the provisions of the Civil Code and Article 20 of the Mortgage Law. Of course, the recordation of this mortgage had to be practiced after the properties mortgaged were recorded in the name of Las Colinas, Inc. in virtue of the Consolidation Agreement presented. In our case, this was exactly what the Registrar did; and under the rules established by the above mentioned cases, we are forced to conclude that the Registrar acted properly and according to law.

Finally, we consider Debtors' contention as to the 196-cuerda parcel acquired by Banco Popular at a judicial sale at which it paid the sum of $179,000.00. Debtors claim that the Bank must be deemed a constructive trustee of the 196-cuerda parcel and that Debtors in Possession are entitled to recovery of title to, and possession of, said land. The general rule is that the burden of proving the existence of a trust is on the party alleging its existence. Prevost v. Gratz, 19 U.S. (6 Wheat.) 481, 5 L.Ed. 311 (1821); Logan v. Logan, 112 S.W.2d 515 (Tex.Civ.App. 1937); 54 Am. Jur., Trusts, Sec. 602, pp. 465-66. To discharge this burden it is required that Debtors' proof be clear and satisfactory. Where a person seeks to enforce a constructive trust he has the burden of establishing facts which give rise to such a trust, and he must establish such facts by clear and convincing evidence, since it is not enough to establish them by mere preponderance of the evidence. Shapiro v. Rubens, 166 F.2d 659 (7th Cir. 1948); National Waste Co., Inc. v. Spring Packing Corp., 200 F.2d 14 (7th Cir. 1952), cert. denied 345 U.S. 909, 73 S.Ct. 649, 97 L.Ed. 1344 (1953); Keates v. Register, 74 F.Supp. 966 (E.D.Pa. 1947); Jacoby v. Shell Oil Co., 196 F.2d 855 (7th Cir. 1952); Smith v. Connor, 87 Ariz.

6, 347 P.2d 568 (1959); McCombs v. McCombs, 227 Ark. 1, 295 S.W. 2d 774 (1956); Honaker v. City of Princeton, 125 W.Va. 672, 25 S.E.2d 772 (1943).

In this case, Debtors did not present convincing and satisfactory evidence as to the existence of a constructive trust. Mr. Vigdor Schreibman, President of Las Colinas, Inc., testified that he first acquired knowledge that the Bank was going to acquire the 196-cuerda parcel in its own name two hours before the auction was held. (Transcript of the Sixth Day of Trial, April 2, 1968, p. 358). He also testified that Mr. Abner Kalisch, Vice President of Banco Popular, had told him over the telephone that morning that the "bank decided it was just going to buy the property in and make it available to the company when it had the money to pay for it" (Id., p. 358). Then attorney for Debtors in Possession asked Mr. Schreibman the following question:

> Was anything said about the subject of the reason or purpose of the bank's acquiring the property?

Mr. Schreibman answered in the following way:

> I don't know the reason. The bank was purchasing it. I don't think we talked about it, the purpose was simply to protect its interest and hold the company, the whole estate together and hold this property as security for the lots it was going to make in purchasing this property. (Id., p. 360.)

On behalf of the Bank, Mr. José Luis Carrión, Executive Vice president, testified that the Bank had purchased the 196-cuerda parcel because it was to the bank's advantage to purchase it. (Transcript of testimony given on August 21, 1967, p. 3). Mr. Carrión also testified that prior to the purchase he had not talked with the officers

of Las Colinas in connection with the purchase of this property. (Id. at p. 5). It was clearly established that the Board of Directors of Banco Popular decided to purchase the 196-cuerda parcel the morning the auction was to be held.

Where land is sold on foreclosure of a mortgage and the owner of the land *is induced to refrain from protecting his interest by the oral promise of another* to buy in the land on the sale and to reconvey it to the owner on his reimbursing the purchaser, the latter can be charged as constructive trustee of the land for the owner. Sec. 5 Scott on Trusts, Sec. 484, 89 C.J.S. Trusts § 147; Bogert, Trusts and Trustees, Sec. 494 (2d ed.). The owner of the land, who has permitted his interest to be extinguished by the sale relying upon the oral agreement of the purchaser, is entitled to be put in status quo if the purchaser refuses to carry out his promise. Scott, op. cit., Sec. 484. There was no evidence presented as to the existence of an oral agreement between Las Colinas, Inc. and Banco Popular, by which the latter promised to reconvey the property purchased to Las Colinas, Inc. All the Bank told Las Colinas was that it was willing to sell or to make the property "available" to Las Colinas. It cannot be argued that said statement, made two hours before the time set for the auction, induced Las Colinas, Inc. to refrain from protecting its interest. There was no proof that Las Colinas, Inc. refrained from bidding at the sale in reliance on the above statement. At the time the statement was allegedly made, Las Colinas had no time to raise the money to get back its property. We have to conclude that, assuming that the Bank's officer made this statement, the same is not equivalent to a declaration of trust or a promise to hold in trust. Roach v. Grant, 134 Tex. 10, 130 S.W.2d 1019 (1939).

Las Colinas' own President, Mr. Vigdor Schreibman, testified that the Bank was going to acquire the 196-cuerda

parcel in its own name in order to protect the Bank's interests. Most of the decisions dealing with constructive trusts in public sales emphasize the effect of the debtors' reliance on the bidder's promise, Sandfoss v. Jones, 35 Cal. 481 (1868); Broadwell v. Smith, 152 Ga. 161, 108 S.E. 609 (1921); Griffin v. Schlenk, 139 Ky. 523, 402 S.W. 837 (1907); others emphasize the chilling of bidding by third persons, Strasner v. Carroll, 125 Ark. 34, 187 S.W. 1057 (1916); Broadwell v. Smith, supra; Holmes v. Holmes, 106 Ga. 858, 33 S.E. 216 (1899); and some comment on the inadequacy of the price paid by the bidder. Bogert, op. cit., Sec. 494. It has been established that a purchase at a judicial sale for an inadequate consideration will not of itself be grounds for a constructive trust, unless the inadequacy is gross. Marlatt v. Warwick, 18 N.J.Eq. 108 (1866). The sum of $179,000.00 paid by Banco Popular was an adequate consideration, and the fact that the property purchased could have greater value for Banco Popular due to its proximity to lands mortgaged in favor of Banco Popular, is not proof that the price paid by the Bank was inadequate. At the most, what Banco Popular did was to offer the property purchased conditioned upon the full payment of Las Colinas' debt, and of course, this cannot be considered as a promise to hold the property in trust. Therefore, we hold that Banco Popular purchased the 196-cuerda parcel in a bona fide transaction and its title is not subject to any equitable or legal attack.

Judgment will therefore be entered in accordance herewith.

San Juan, Puerto Rico, December 4, 1968.

/s/ HIRAM R. CANCIO
Chief Judge

FILED & ENTERED
DEC. 4, 1968
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SAN JUAN, PUERTO RICO

Opinion of the Court of Appeals for the First Circuit, per McEntee, Circuit Judge

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 7469

IN THE MATTER

of

LAS COLINAS, INC. and EASTERN SHORE DEVELOPMENT CORPORATION, Debtors,

Appellants.

Appeal of VIGDOR SCHREIBMAN,

Appellant.

May 14, 1970

McENTEE, Circuit Judge.

Appellants, Las Colinas, Inc. and Eastern Shore Development Corporation, are debtors in possession in proceedings brought under Chapter XI of the Bankruptcy Act. Their controversy with Banco Popular de Puerto Rico arises out of a plan to develop a large tract of land in Puerto Rico for residential and recreational purposes. The idea was conceived by Vigdor Schreibman and put into effect in 1961 by the appellants.[1] The bank provided

[1] Originally five corporations were involved in the project: Las Colinas, Inc.; Arenas, Inc.; Ceiba Corporation, Eastern Shore Development Corporation and Eastern Construction Corporation. Las Colinas, Inc. originally purchased all of the properties comprising the project. Arenas, Inc purchased 100 cuerdas from Las Colinas and was the developer of section one. Eastern Shore Development Corporation contracted to perform services required for general planning, financing and sales promotion for the entire project. Eastern Construction Company, a wholly owned subsidiary of Eastern Shore, was hired as prime contractor. In 1964 all the corporations except Eastern Shore were merged and took the common name Las Colinas, Inc. Schreibman is president of both corporations.

interim financing in exchange for promissory notes secured by mortgages on certain portions of the land. By the end of 1963 differences between the parties led the bank to refuse to advance further funds, and, shortly thereafter, construction came to a halt. As the result of this impasse, in July 1964 the bank sued in the Commonwealth Superior Court to foreclose the mortgages.[2] Three months later appellants filed for an arrangement pursuant to Chapter XI.[3]

The present appeal is brought by the debtors in possession from an adverse decision of the bankruptcy court permitting the bank to have certain of the mortgaged property sold at public auction to satisfy the indebtedness.

Before turning to the merits of the case, we must determine whether or not the scope of our review is affected by the fact that the lower court, in rendering its opinion, adopted almost verbatim the proposed findings of fact and conclusions of law submitted by the bank at the close of trial so that the entire opinion occupying some twenty printed pages was written from end to end by counsel. Appellants contend that this adoption of findings and conclusions drafted by an interested party was improper, that the opinion does not reveal the discerning line for decision of some of the basic issues in the case and that under the circumstances we should render a decision on the merits in favor of the debtors.

Fed.R.Civ.P. 52(a) requires the trier of fact to find the facts specially and state his conclusions of law regarding the grounds of the action. The purpose of the rule, it is said:

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[2] By agreement of the parties these proceedings were later terminated and jurisdiction over all issues was transferred to the district court sitting in bankruptcy. This included a counterclaim filed by Las Colinas for $5,000,000 in actual and punitive damages.

[3] An attempt by a creditor to transfer the proceedings to a Chapter X Reorganization was the subject of prior litigation before this court. Schreibman v. Mason, 377 F.2d 99 (1st Cir. 1967).

> "is to require the trial judge to formulate and articulate his findings of fact and conclusions of law in the course of his consideration and determination of the case and as a part of his decision making process, so that he himself may be satisfied that he has dealt fully and properly with all the issues in the case before he decides it and so that the parties involved and this court on appeal may be fully informed as to the bases of his decision when it was made." Roberts v. Ross, 344 F.2d 747, 751 (3d Cir. 1965).

The practice of inviting counsel to submit proposed findings of fact and conclusions of law is well established as a valuable aid to decision making. Nordbye, Improvements in Statement of Findings of Fact and Conclusions of Law, 1 F.R.D. 25, 30 (1940). Nonetheless, a clash of interests must be recognized to exist between efficient administration that leads hard pressed judges to turn to counsel for help and the undeniable rights of losing counsel to be assured that his position has been thoroughly considered. The court's findings must ultimately represent the judge's own determination. United States v. Forness, 125 F.2d 928 (2d Cir.), cert. denied, City of Salamanca v. United States, 316 U.S. 694, 62 S.Ct. 1293, 86 L.Ed. 1764 (1942). The independence of the court's thought process may be cast in doubt when the findings proposed by one of the parties winds up as the court's opinion[4] and the courts have

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[4] The danger inherent in the practice is well stated in Brenger v. Brenger, 142 Wis. 26, 125 N.W. 109 (1910), quoted in Otis, Improvements in Statement of Findings of Fact and Conclusions of Law, 1 F.R.D. 83, 85 (1940):

> "Experience shows that counsel, the most able, honorable and conscientious, * * * after the close of a hotly contested case, are not in the frame of mind, ordinarily best suited to drafting the findings, which must express the judgment of the court. That is no criticism. It is only an acknowledgement of the natural infirmities of the most perfect of us. All are affected regardless of ability or purity; the difference is in degree. The making of the findings is purely a judicial function."

not looked with favor upon the practice.[2] The district court's action in this case does not in any way alter its deserved reputation for conscientiousness. We suspect no abandonment of judicial responsibility. At the same time we have a concern that as a matter of general practice in all courts within our jurisdiction the appearance reflects the actuality.

In Nyyssonen v. Bendix Corporation, 342 F.2d 531, 532 (1st Cir.), cert. denied, 382 U.S. 847, 86 S.Ct. 65, 15 L.Ed. 2d 86 (1965), this court considered the contention that, by adopting a portion of defendant's draft findings of fact verbatim, the district court denied plaintiffs due process of law. Although we rejected that contention, we expressed the view that "ordinarily we think it the better practice for the trial court to prepare its own findings with such help as it may derive from counsels' requests." We were

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[2] United States v. El Paso Natural Gas Co., 376 U.S. 651, 84 S.Ct. 1044, 12 L.Ed.2d 12 (1964); Roberts v. Ross, 344 F.2d 747, 752 (3d Cir. 1965); Nyyssonen v. Bendix Corp., 342 F.2d 531 (1st Cir. 1965); Rooted Hair, Inc. v. Ideal Toy Corp., 329 F.2d 761, 769 (2d Cir.), concurrence), cert. denied, 379 U.S. 831, 85 S.Ct. 63, 13 L.Ed.2d 40 (1964); Chicopee Mfg. Corp. v. Kendall Co., 288 F.2d 719, 724 (4th Cir.), cert. denied, 368 U.S. 825, 82 S.Ct. 44, 7 L.Ed.2d 29 (1961); *compare* Louis Dreyfus & Cie v. Panama Canal Co., 298 F.2d 733 (5th Cir. 1962 *with* Atwood v. Humble Oil and Refining Co., 338 F21 502, 512) (5th Cir. 1964), cert. denied, 381 U.S. 926, 85 S.Ct. 1562, 14 L.Ed.2d 684 (1965). *See also* Otis, Improvements in Statement of Findings of Fact and Conclusions of Law, 1 F.R.D. 83, 85 (1940); Wright, The Non Jury Trial—preparing Findings of Fact and Conclusions of Law, quoted in United States v. El Paso Natural Gas Co., *supra*, 376 U.S. at 656-657, 84 S.Ct. 1044 n. 4. *But see* Bradley v. Maryland Casualty Co., 382 F.2d 415, 422-423 (8th Cir. 1967); Schnell v. Allbright-Nell Co., 348 F.2d 444, 446 (7th Cir. 1965), cert. denied, 383 U.S. 934, 86 S.Ct. 1062, 15 L.Ed.2d 851 (1966); United States v. Cornish, 348 F.2d 175, 181 n. 8 (9th Cir. 1965); O'Leary v. Liggett Drug Co., 150 F.2d 656, 667 (6th Cir.), cert. denied, 326 U.S. 773, 66 S.Ct. 232, 90 L.Ed. 467 (1945); *See generally* 2B W. Barron & A. Holtzoff, Federal Practice and Procedure § 1124 (Wright ed. 1961).

emphatic that *Nyyssonen*, a complex patent litigation, was not an ordinary case. The district judge, while candidly recognizing his own limitations in the area, left no doubt that to the best of his ability he had made an independent study of the record. Under the circumstances, we thought him justified in adopting the proposed findings in order to avoid the risks of scientific and technological error. *See* Radio Corporation of America v. Philco Corporation, 275 F.Supp. 172, 210 (D.N.J.1967).

The issues confronting the court in the instant case do not resemble those in *Nyyssonen*, and we reiterate that we think the practice of adopting proposed findings verbatim should be limited to extraordinary cases where the subject matter is of a highly technical nature requiring expertise which the court does not possess.

Nevertheless, the Supreme Court, in an antitrust action, has held that "findings, though not the product of the workings of the district judge's mind, are formally his; they are not to be rejected out-of-hand, and they will stand if supported by evidence." United States v. El Paso Natural Gas Co., 376 U.S. 651, 656, 84 S.Ct. 1044, 1047, 12 L.Ed.2d 12 (1964). That is not to say, however, that courts will not make the most searching examination for error in such cases. In Louis Dreyfus & Cie. v. Panama Canal Company, 298 F.2d 733 (5th Cir. 1962), the court held that even though the clearly erroneous rule was not erased by the practice of adopting counsels' proposals, without the "badge of personal analysis," reviewing courts in close cases should feel more justified in remanding with a direction that further findings be made.[*] *See* Roberts v. Ross, *supra*, 344 F.2d at 752. The factors that led the *Dreyfus* court to find that "maximum doubt is cast on the findings

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[*] The governing principles are described by the court in *Dreyfus*, *supra*, at 738-739.

of fact by their adoption from the litigant's proposals" are also present in the instant case. Both involve lengthy opinions containing discussion of numerous issues and sharply disputed facts founded upon evidence largely oral in nature. Consequently, we deem it appropriate to apply the *Dreyfus* standard to the facts developed in the opinion of the court below.

We in no way suggest that courts may not receive conventional requests for findings and adopt those submitted by one party and reject those of the other. However, the greater the extent to which the court's eventual decision reflects no independent work on its part, the more careful we are obliged to be in our review.

1. The Loans

Beginning in 1961, Schreibman and certain bank officials negotiated to establish the terms under which the bank would undertake the financing of the project. The bank initially agreed to finance the development of a fifty cuerda[7] tract, further financial assistance to be conditional on the success of this first section. On the basis of plans, budgets, cost estimates and an estimated time of completion of six months, the bank, on September 19, 1961, approved a line of credit for site development in the amount of $482,000. The six month projection to complete the project proved optimistic, as work on the site did not get under way until March, 1962. On September 18, 1962, while work on the land was still in progress, the bank extended a second line of credit for $500,000 to be used for the construction of forty-six houses in the first section. The court found that both loans were to be repaid from the proceeds of the sale of lots and houses, and that although no time was specified, repayment was to be made

[7] A cuerda is just less than an acre.

within six months af each loan or within a reasonable time thereafter. In neither case was the deadline met.

Despite the fact that the work on both land and houses was incomplete in February-March 1963, the court found that on June 18, 1963, the bank increased the line of credit by $768,000, bringing the total to $1,750,000. As found by the court, this amount represented a maximum figure to be used to finish the site development and the construction of forty-six houses in the first section.[5] Although the evidence disclosed no time for repayment, again the court concluded that the parties intended repayment to be made within six months. Accordingly, it held that in the absence of conclusive evidence to the contrary, the bank was entitled to demand payment in December 1963 of all sums owed to it.

Although there is no disagreement that the source of repayment was to be the sale of lots and houses, appellants dispute the finding that under the terms of the agreement the $1,750,000 credit line was a gross amount to be repaid in a lump sum at a specified time. Schreibman testified that the financing was to be accomplished by a revolving line of credit. Under this system, the bank would make loans up to $1,750,000 to develop section one. As lots and houses were sold, the proceeds would be used to reduce the amount of the indebtedness. The bank would then make further loans to enable the appellants to prepare more lots and houses for sale. By this method the total indebtedness would never exceed $1,750,000 although the total cost of development might be much greater. Schreibman further testified that in December 1963, the appellants stood ready

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[5] Although the parties are not in agreement as to whether the bank had given its approval to construct more than forty-six houses, the court found that the bank was aware of the fact that more than that number of units were being built and had given its reluctant approval for at least partial financing of these additional units.

to begin revolving the loan, but that the bank repudiated its agreement.

Schreiboman also testified that a comprehensive budget for section one was not available until January 1963 and that it was May 1963 before it was submitted to the bank in final form. This "Arenas Final Budget," set forth the full cost for the completion of section one, the construction of ninety-two houses and general administrative expenses. The total was estimated to be $2,771,467.82. It is apparent that a question of central importance on the issue of whether the line of credit granted on June 18, 1963, was a revolving one was whether the Arenas Final Budget was accepted by the bank. If it was, then only by viewing the $1,750,000 as a revolving credit line could completion become a reality. Although appellants presented evidence on this issue,[2] the court did not make adequate findings of fact with reference to it.

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[2] Notwithstanding their disagreement respecting the total cost of completing section one and the manner of repayment, the parties stipulated as to the mechanism by which the work was to be financed as it proceeded. Arenas would submit for approval cost estimates requesting funds for a specified purpose. Subsequently, requisitions would be submitted to the bank showing that the purpose of the amounts requisitioned was in the amount shown in the previously accepted cost estimates. The record discloses that the requisitions submitted and approved subsequent to May 15, 1963, gave the amount of the budget for house construction as that stated in the Arenas Final Budget. Appellants take the position that this is some evidence that the guidelines set forth in the Arenas Budget had been accepted. Appellants also submitted evidence which they contend demonstrates that no matter whose figures are used, the $1,750,000 would have been inadequate to complete the project.

The bank contends that whatever the credit arrangement, by December 1963, it had already advanced $1,776,532.63 or $26,532.63 beyond the line of credit approved, and was therefore released from any reciprocal obligation. Appellants dispute this contention. In any event, the court did not base its decision on this point.

Opinion of the Court of Appeals for the First Circuit, per McEntee, Circuit Judge.

Rather than addressing itself to this question, the court's opinion turns on whether it would be "contrary to business sense and common sense" to set a time for repayment beyond the projected completion date," whether any reasonable bank would commit itself to a project without waiting to see the outcome of the first stage, and on an internal loan memorandum submitted by the bank. The court relied on the testimony of the "bank's officials" to establish that "the six month period seems to be the period of time agreed upon," although it expressly found that there was no evidence of an agreement as to any extension of time to complete the works after the line of credit was increased to $1,750,000." The time projections the court relied on were those under the first two loans, which had obviously been

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" In fact, a revolving credit line is a long recognized credit device. Schneider-Davis Co. v. Hart, 23 Tex.Civ.App. 529, 57 S.W. 903 (1900).

" Apparently the officials relied on are Soto and Kalisch. We regard their testimony as extremely tenuous. The bank represents in its brief that Soto testified that the credit in the amount of $768,000 was intended to be paid in six months. Examination of the cited testimony discloses that Soto was testifying as to a loan of $188,000 made in February 1963, which was within the prior lines of credit and had nothing to do with the line granted the following June. With reference to the bank's Exhibit E, Profit Projection and Financial Statement, Soto testified that "this report states conclusively that by December 23 they planned to have completed everything * * * and by that time they would have paid us out completely." Exhibit E contains no such statement. Finally, the court asked, "Did Mr. Schreiberman specifically say he would finish by December and he would pay by December the full amount?" To this Soto replied, "Yes, sir." On cross-examination, counsel for the appellants brought out the fact that in prior proceedings this witness had testified that "no specific time limit was fixed, but we did request from the corporation that they produce a schedule so that we could determine more or less what was the time in which they intended to perform these works."

Mr. Kalisch, the bank's investment director, would say only that he thought the time discussed was "within a year."

abandoned as unrealistic when the work did not get started on schedule. The court's further ruling that the six month projections "refute the assertion that the bank had agreed to readjust the financial commitments according to preliminary or additional budgets to be submitted by Debtors" is the only mention made of the Arenas Final Budget, and in view of the foregoing is totally inadequate.

Several times the court repeated its conviction that it was most improbable that a bank would commit itself to a multimillion dollar project before seeing the results of the first section. But that sentiment is a mere abstraction. The issue is what this bank did, and that cannot be resolved until the questions raised by the Arenas Final Budget are dealt with.

The court also relied on an internal loan memorandum to establish that the amount loaned was not to exceed $1,750,000. But Kalisch testified that these forms "are administrative guides, they do not necessarily represent the facts as they existed."

We have said that the clearly erroneous rule is not abrogated where the district court adopts verbatim the proposed findings submitted by one of the parties. However, we think this case falls within the "narrow range of doubtful cases" in which the absence of the "badge of personal analysis" justifies our conclusion that important evidence has been inadequately considered. *Dreyfus, supra*, 298 F.2d at 738-739. The question of whether the Arenas Final Budget was accepted is intimately connected with the question whether the loan was intended to revolve.[12] Appellants' evidence on that issue must be given thorough consideration. We see no alternative but to remand this part of the case for a finding on that question.

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[12] Significantly, Jose Luis Carrion, Executive Vice President of Banco Popular, testified that the second $500,000 line of credit for house construction was a revolving loan.

2. The $2,000,000 Mortgage

Each line of credit extended by the bank was evidenced by a promissory note secured by a mortgage on certain of the development land. The first line of credit for $482,000, granted on September 19, 1961, was secured by a bearer mortgage note in the amount of $500,000. This mortgage, executed on April 26, 1962, encumbered the land under actual development. The second line of credit, for $500,000, granted on September 18, 1962, was secured by a mortgage for a like amount. This mortgage was executed on February 5, 1963, and constituted a second lien on the same land mentioned above. On February 4, 1963, another mortgage in the amount of $750,000 was executed encumbering an undeveloped portion of the property. This $750,000 mortgage preceded by four and one-half months the final extension of the line of credit to $1,750,000. Finally, on December 20, 1963, the bank asked for and received additional security in the form of a $2,000,000 bearer mortgage note as a third mortgage on the land under development. It is with this last encumbrance that appellants take issue.

They contend that the $2,000,000 mortgage, insisted upon by the bank at a time when the project was in financial straits, constituted grossly excessive security in view of the fact that the bank already held mortgages with a face value of $1,750,000 for loans of precisely that amount. They claim that the result of this transaction, which placed an encumbrance of $2,750,000 on their land, was the destruction of the project.

In upholding this transaction, the court found that prior to December 1963 the bank had security of only $1,000,000 which was less than the total loans outstanding. In fact the bank also held the $750,000 mortgage described above on an undeveloped section of land. At a meeting on December 18, 1963, the bank requested the $2,000,000 mortgage

because, as the court found, it "preferred to have the additional mortgage security on land which was being developed and where the amounts advanced by it were expended." Although the court recognized that the $2,000,000 mortgage exceeded the actual debt, it held that it was not unreasonable in view of the fact that the parties were at that time negotiating for future advances. Thus, "it seemed practical and logical to issue and deliver a mortgage note in excess of the debt which could serve as security in case the request for additional financing was approved by the Bank." 204 F. Supp. 582, 593. The court also found that there was no evidence that an agreement regarding these additional funds was ever consummated.

In a corporate resolution dated December 20, 1963, authority was given to Schreibman as president to execute a promissory note secured by a mortgage for $2,000,000 "as additional security of loans made prior to this date and as security of advances to be made by the banking institution subsequent to this date." The court found that the mortgage documents were consented to by almost all the directors, the majority by written consents on December 20 and "the others by telephone."

At the time of the transaction, Las Colinas had a board of directors consisting of seven members. Of the four directors who actually signed the authorization, two were also officers of the bank.[13] Of the three who did not sign, two were out of the country and, contrary to the finding by the district court, did not give their consent by telephone.[14]

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[13] Abner Kalisch, Sr., Vice President of Banco Popular, and director of the investment division, and Carlos Conde, Assistant Vice President, Investment Department.

[14] Attorney Summers testified that he and Schreibman made the telephone calls. One director could not be reached. The other refused to consent over the telephone. Neither ever consented in writing.

The third, Summers, was attorney for Las Colinas. He testified that he intended to sign and did sign, thinking it critical that they secure additional financing from the bank. Inexplicably his signature does not appear on the corporate resolution. Even if Summers is counted among the approving directors, however, it is apparent that the resolution would not have carried without the votes of the two bank officers.

Appellants contend that the participation of Kalisch and Conde puts the case in the same category with interlocking directorate cases, in which the burden of proof on the issue of fairness is on the party seeking to uphold the transaction. Geddes v. Anaconda Copper Mining Company, 254 U.S. 590, 599, 41 S.Ct. 209, 65 L.Ed. 425 (1921). The bank would distinguish the instant case by the fact that the two bank officers had no personal interest in the transaction, did not benefit from it, did not own shares or request to be appointed directors. It relies heavily on 3 W. Fletcher, Cyclopedia on Corporation § 968 (1958), which states:

> "A director of one corporation may vote or otherwise seek in a legitimate way security for an honest debt due from that corporation to another of which he happens to be an officer."

But reliance on this statement begs the question of whether the transaction was in fact legitimate. Nor does it deal with the question presented here of who bears the risk of non-persuasion.

We perceive no reasoned distinction between the interlocking director cases and those where the same individual serves one corporation as a director and another as an officer. The principle that one who is in a fiduciary capacity cannot serve two masters is no less controlling where, despite his title, he is so placed that his decisions affect the

financial condition of two companies. Modern corporation law has erased such artificial distinctions.[13] Such was the law in this circuit as early as a half century ago. Irving Bank Columbia Trust Company v. Stoddard, 292 F. 815 (1st Cir. 1923). There, loan agreements and assignments had been made by the directors of the defendant company while they were also officers or representatives of the banks extending the loans. These facts, we held "casts upon those who seek to uphold the transaction the burden of showing that it is fair and absolutely free from fraud." *Irving Bank*, *supra*, at 819. Although the Supreme Court of Puerto Rico has not passed on this issue, it has voiced its concern for transactions in which a fiduciary's personal interest may be in conflict with that which he is bound to protect. McCormick v. Gonzalez, 49 P.R.R. 460, 469 (1936).

The record before us reflects an utter failure to demonstrate the fairness of the transaction. The amount of the mortgage demanded by the bank was, as the court recognized, far in excess of the outstanding indebtedness. The

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[13] R. Baker and W. Cary, Cases & Materials on Corporations 440 (3d ed. 1959); *see* N.Y. Business Corporation Law § 713 (McKinney's Consol.Laws, c. 4, Supp. 1969): "Interested directors.—(a) No contract or other transactions between a corporation and one or more of its directors, or between a corporation and any other corporation, firm, association or other entity in which one or more of its directors are directors or officers, or are financially interested, shall be either void or voidable for this reason alone or by reason alone that such director or directors are present at the meeting of the board, or of a committee thereof, which authorized such contract or transactions, or that his or their votes are counted for such purpose:

* * * * *

(3) If the contract or transaction is fair and reasonable as to the corporation at the time it is authorized by the board, a committee or the shareholders." *See also* Calif.Gen.Corp.Code § 820 (Deering Supp.1970); 8 Del.Gen.Corp.Law § 144 (West Supp.1968).

only justifications offered for this exorbitant security are (1) that future advances were under consideration and it was reasonable for the parties to include this in their calculations and (2) that the land encumbered by the $750,000 mortgage was "not the best security." Whatever negotiations were taking place regarding future advances, the fact of the matter is that no mention of that subject is found in the mortgage deed and no such loans ever materialized.[16] In any event, even by the debtors, projected figures to finish the project, this security would have been excessive.

As to the value of the land encumbered by the $750,000 mortgage, the bank offered in evidence to show that it was not what its face value indicated.[17] This was part of the bank's burden on the issue of fairness, and in the absence of evidence to the contrary, the face value shall be presumed to coincide with its actual value. The fact that the

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[16] Butts v. Peacock, 23 Wis. 359 (1868), was a suit by a creditor to hold a mortgage fraudulent and void on the ground that the transaction in question tended to hinder and delay the creditors of the mortgagor. The court held that the fairness of the transaction must be judged by the surrounding circumstances. The mortgage was given, the court found, at a time when the mortgagor was in financial trouble, pressed by his creditors and apprehensive that he would lose everything. The creditor knew of this before he took the mortgage, nevertheless, he took a mortgage of $1,100 on all the mortgagor's property to secure an indebtedness of only $570. Although he claimed that it was intended to cover future advances, "nothing of the kind appeared on the face of the mortgage, which purported to be for an absolute existing indebtedness." The court held the mortgage void as against creditors. *See* Kellogg v. Clyne, 54 F. 696, 700 (8th Cir. 1893).

[17] Quite to the contrary, one Nazario, an expert witness called by the debtors in possession, established the value of the undeveloped land at between $2,000-$2,500 per cuerda. There were 356 cuerdas in the parcel securing the $750,000 note.

parties had entered into an agreement whereby appellants pledged to deliver such security as the bank deemed adequate does not affect the result here. That agreement can not prevail against a charge of unfairness.

The appellants are entitled to receive such damages as they have shown resulted from this transaction. On that issue, this segment of the case is also remanded. In determining the amount of damages, the court, on remand, shall not take into consideration appellants' allegation that they were deceived into thinking that an agreement had been struck to make the advances and substitute the $750,000 mortgage. Contrary to his own position, Schreibman testified on direct examination that the mortgage was intended as additional security and that at the time it was given no obligation was incurred by the bank. In light of this testimony, we need not undertake any further examination of the evidence in order to hold that the district court's finding on that issue is supported by the evidence. This is in no way inconsistent with our ruling that the bank failed in its burden to show that the security was not grossly excessive in light of the surrounding circumstances.

3. The 196 Cuerda Property

In 1960 Las Colinas purchased three tracts totalling 390 cuerdas from the Penedo family, giving a purchase money mortgage as security for part of the price. Upon a default in payment, the Penedos foreclosed the mortgage and the bank purchased a 196 cuerda portion of the property at a judicial sale. Appellants now seek to have the bank divested of title on the ground that the purchase money mortgage given Penedo was void for failure to comply with § 215 of the Mortgage Law, 30 L.P.R.A. § 215

(1966),[18] which provides, in essence, that where several estates are mortgaged to secure a single obligation, the amount of the lien borne by each must be set forth in the instrument.[19] This contention raises two issues: (1) whether the bank, a stranger to the original transaction, holds subject to any such infirmity in the mortgage and (2) whether the mortgage complies with § 215. We shall dispose of the first point briefly.

A mortgage which fails to comply with § 215 may not be recorded in the registry.[20] And, since under Puerto Rican law recording is essential to the validity of a mortgage,[21] one that is not recorded is a nullity.[22] Moreover, the inadvertent admission to record of a void instrument does not cure the infirmity.[23] Finally, subsequent purchasers

[18] The bank claims that appellants are estopped to deny the validity of the mortgage because the issue they raise was litigated in the Penedo foreclosure proceeding in the Commonwealth court and determined adversely to their interest. We cannot agree. Collateral estoppel, even if applicable here, is an affirmative defense. Fed.R.Civ.P. 8(c). The bank's failure to raise it in the district court precludes its assertion here. C. Wright & A. Miller, Federal Practice and Procedure: Civil § 1278 (1969); *see* Halkey v. United States, 367 F.2d 22 (1st Cir. 1966).

[19] We note in passing that no objection has ever been made to the fact that Penedo was not joined as a party under Fed.R.Civ.P. 19. An appellate court may raise the question of want of an indispensable party *sua sponte*. 3A J. Moore, Federal Practice ¶ 19.07[1], at 2223 (2d ed. 1969); 2 W. Barron & A. Holtzoff, Federal Practice and Procedure § 516, at 100-103 (Wright ed. 1961 and Supp. 1968). We are satisfied, however, that Penedo was not an "indispensable" party. 3A J. Moore, *supra*, at 2253; Stevens v. Loomis, 334 F.2d 775, 777-778 (1st Cir. 1964).

[20] J. M. Portela & Co. v. Registrar, 41 P.R.R. 261 (1930); 30 L.P.R.A. § 1085 (1968).

[21] 30 L.P.R.A. § 259 (1966); 31 L.P.R.A. § 5042 (1968).

[22] *See, e. g.*, Gaztambide v. Heirs of Ortiz, 70 P.R.R. 388, 412 (1949).

[23] 30 L.P.R.A. § 58 (1966); Jiminez v. Alvarez, 69 P.R.R. 299 (1948).

of land are protected against such void instruments only to the extent that the defect in title is not apparent from the record.[7] Since a violation of § 215 is apparent on the record, as the mortgage is open to inspection, the bank is not protected against any alleged violation.[8]

This brings us to the question of the mortgage's compliance with § 215. In paragraph Tenth the mortgage distributes the amount of the lien among three parcels in rough congruence to their sizes. This much of the instrument appellants concede meets the requirements of § 215. By paragraph Eleventh, however, the land is subdivided into four parcels of approximately 100 cuerdas each, and it is stipulated that the mortgagee will release from the mortgage lien one of the four 100 cuerda parcels upon the payment of one quarter of the total indebtedness. Paragraph Twelfth goes on to state that none of the land would be released from the mortgage lien until the mortgagor had made payments of $125,000 toward the reduction of certain other mortgages, which do not appear in the record, and the instant mortgage.

The parties are agreed that paragraph Eleventh and Twelfth nullify the distribution of the debt made by para-

[7] Annoni v. Heirs of Nadal, 135 F.2d 499, 501 (1st Cir. 1943), *affirming* 59 P.R.R. 638, 642-644 (1941); Hernandez v. Caraballo, 74 P.R.R. 27, 34-35 (1952); Rivera v. Melendez, 72 P.R.R. 404, 410-411 (1951); Cruz v. Heirs of Gonzalez, 72 P.R.R. 298 (1951); Gaztambide v. Heirs of Ortiz, *supra* n. 22, at 400 (1949); King v. Fernandez, 30 P.R.R. 550 (1922).

[8] The fact that the bank bought at a judicial sale puts it in no better position. Rivera v. Melendez, 72 P.R.R. 404, 410-411 (1951); *see* Ramos v. Rios, 79 P.R.R. 693, 696 n. 2 (1956); Gaztambide v. Heirs of Ortiz, *supra* n. 22, at 402-404; Santiago v. Rios, 69 P.R.R. 397 (1948); Ayala v. Flores, 50 P.R.R. 823 (1937); Delgado v. Rivera, 41 P.R.R. 784, 792-793 (1931); Anaud v. Martinez, 40 P.R.R. 641 (1930).

graph Tenth. Appellants contend that the instrument
a whole violates 215 and is void. Appellees argue t
the offending provisions are void, but severable from t
mortgage.

We think the result here is controlled by *Credito*
Ahorro Ponceno v. *Registrar*, 30 P.R.R. 731 (1922)[25]
that case, the mortgage distributed the indebtedn
among several parcels in accordance with 215. How
by subsequent paragraphs it stated that each of the mo
gaged properties was to respond for the entire debt
that none of the liens on the properties would be cancell
until the entire debt was cancelled. The Supreme Court
Puerto Rico upheld the refusal of the registrar to reco
the mortgage on the ground that it violated 215. Ho
the court held that subsequent mortgage provisions co
tradicting a distribution made under 215 render
entire mortgage unrecordable.

While we are dealing here with a mortgage whi
under *Credito*, was erroneously recorded, the distinct
is immaterial. We are bound to follow Puerto Rican la
in this matter. And since under Commonwealth law,
void mortgage is not validated by inadvertent recording
it follows that a mortgage which would not have be
recordable—and would therefore have been a nullity—ca
not become partially effective by virtue of an improp
recording.

While the foregoing is dispositive of the issue, we thi
it well to add that this result is entirely consistent wi
and, in our view, mandated by the policy of 215. T
purpose of that statute was to protect the general eco
of the country by preventing creditors from taking e
cessive security for their debts.[26] The vice to be avoid
was that the collateral of a debtor would be encumb

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[25] Note 21, *supra*.

[26] Credito y Ahorro Ponceno v. Registrar, *supra*, at 733.

to a degree unwarranted by the outstanding debt, thereby preventing him from obtaining further financing. Under the mortgage in the instant case a prudent, potential creditor would look not only to paragraph Tenth to determine the extent of the mortgagee's interest in the land, but to paragraphs Eleventh and Twelfth as well. It is highly unlikely that a creditor would measure the mortgagee's interest by any standard other than that least favorable to the mortgagor. The inclusion of contradictory paragraphs in the mortgage of the type here involved would therefore have precisely the effect that the statute sought to avoid. To treat them merely as severable would be of no material benefit because a potential creditor could not rely upon the possibility of their eventual cancellation in deciding whether to advance funds to the mortgagor. Accordingly, the policy of the statute dictates that the entire instrument be treated as void.[7]

Our decision requires that the judgment be vacated and the case remanded for appropriate findings of fact after a complete re-examination of the evidence on the issue of whether the parties intended the financing to be in a revolving line of credit. On the issue concerning the execution of the $2,000,000 mortgage, the case is remanded for a determination of damages. The bank will be divested of title to the 119 parcels purchased at judicial sale and the parties shall be returned to the status quo.

The judgment of the district court will be vacated and the case remanded for further proceedings consistent with this opinion.

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[7] Of course, the invalidity of the mortgage does not extinguish the obligation.

Appellants also argue that the same provisions of the mortgage render all the mortgages invalid because they resulted in a lien of $3,750,000 to secure a $1,750,000 debt without disclosing the amount of actual debt for which each property was responsible. Decision on this point is unnecessary in view of our disposition of

Memorandum Opinion of the District Court for Puerto Rico per Cancio, Chief Judge

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF PUERTO RICO

No. 2884

IN THE MATTER

of

LAS COLINAS, INC. and EASTERN SHORE DEVELOPMENT CORPORATION,

Debtors

December 31, 1970

CANCIO, Chief Judge.

Debtors are developers of a large tract of land located in the municipality of Fajardo and Ceiba, Puerto Rico, in which they engaged in the construction and sale of houses and lots to the public, the project being known as "Las Colinas Development". Banco Popular de Puerto Rico provided certain funds for the interim financing of the project in exchange for promissory notes secured by mortgages on certain portions of the land. By December 1967, the Bank had loaned the Developers $1,700,000. Section I of the project was being built, including development of the lots, and the construction of 81 houses was in progress. By that time, differences between the parties led the Bank to refuse to advance further funds, and shortly thereafter, construction came to a halt. At the height of this impasse, in July 1968, the Bank went in the Commonwealth Superior Court to foreclose the mortgages. The

months later, appellants filed for an arrangement pursuant to Chapter XI of the Bankruptcy Act.

The success of the arrangement was dependent, in substantial part, upon completion of Section I of the project which was in a relatively advanced stage of progress when the project came to a halt. This, in turn, was dependent upon the resolution of the controversy between the Bank and the Debtors in a manner favorable to the debtor.

Due principally to lack of adequate financing, no real progress in the arrangement was made during the period following the Petition, and in August of 1965, one of the creditors petitioned the Court to transfer the proceedings from Chapter XI to Chapter X. In the following December, the Court granted such petition, under the belief that it was in the best interests of all parties.

Nevertheless, upon review of an appeal taken to the United States Court of Appeals for the First Circuit by the Debtors, the Appellate Court vacated the order shifting proceedings to Chapter X as a result of error by this Court in interpreting the related legal guidelines established by the Supreme Court, *Schreiboman* v. *Mason*, 1 Cir., 1967, 377 F. 2d 99. The Court noted that the key to any possibility of reorganization rested upon the outcome of the pending litigation between the parties. Upon remand of the case for further proceedings, the Debtors and the Bank agreed to terminate the Commonwealth Superior Court foreclosure proceedings and jurisdiction over all issues was transferred to this Court sitting in bankruptcy. This included a counterclaim filed by Las Colinas for $5,000,000 in actual and punitive damages.

After a lengthy trial, the Court requested from Counsel for the respective parties, proposed findings of fact and conclusions of law, which were subsequently filed. On December 4, 1968, the Court entered its opinion in the matter

denying all relief sought by the Debtors and granting the relief sought by the Bank, *In Re Las Colinas, Inc.*, D. Puerto Rico, 1968, 294 F. Supp. 582. Judgment was entered on January 13, 1969.

The Debtors prosecuted an appeal from said judgment, and on May 14, 1970 the United States Court of Appeals for the First Circuit issued its opinion dealing with the merits of the controversy between the parties. *In Re Las Colinas, Inc.*, 1 Cir., 1970, 426 F. 2d 1005.

The principal issues raised by the controversy are set forth in a succinct manner by the Appellate Court in its opinion, as follows:

I. The Loans

"Although there is no disagreement that the source of repayment was to be the sale of lots and houses, appellants dispute the finding that under the terms of the agreement the $1,750,000 credit line was a gross amount to be repaid in a lump sum at a specified time. Schreibman testified that the financing was to be accomplished by a revolving line of credit. Under this system, the bank would make loans up to $1,750,000 to develop section one. As lots and houses were sold, the proceeds would be used to reduce the amount of the indebtedness. The bank would then make further loans to enable the appellants to prepare more lots and houses for sale. By this method the total indebtedness would never exceed $1,750,000, although the total cost of development might be much greater. Schreibman further testified that in December 1963, the appellants stood ready to begin revolving the loan, but that the bank repudiated its agreement.

"Schreibman also testified that a comprehensive budget for section one was not available until January 1963, and that it was May 1963 before it was submitted to the bank

in final form. This 'Arenas Final Budget' set forth the full costs for completion of section one, the construction of ninety-two houses and general administrative expenses. The total was estimated to be $2,771,467.82. It is apparent that a question of central importance on the issue of whether the line of credit granted June 18, 1963 was a revolving one was whether the Arenas Final Budget was accepted by the bank. If it was, then only by viewing the $1,750,000 as a revolving credit line could completion become a reality." 426 F. 2d at 1010-1011.

2. The $2,000,000 Mortgage

"Each line of credit extended by the bank was evidenced by a promissory note secured by a mortgage on certain of the development land. The first line of credit for $482,000, granted on September 19, 1961, was secured by a bearer mortgage note in the amount of $500,000. This mortgage, executed on April 26, 1962, encumbered the land under actual development. The second line of credit, for $500,000 granted on September 18, 1962, was secured by a mortgage for a like amount. This mortgage was executed on February 5, 1963, and constituted a second lien on the same land mentioned above. On February 4, 1963, another mortgage in the amount of $750,000 was executed encumbering an undeveloped portion of the property. This $750,000 mortgage preceded by four and one-half months the final extension of the line of credit to $1,750,000. Finally, on December 20, 1963, the bank asked for and received additional security in the form of a $2,000,000 bearer mortgage note as a third mortgage on the land under development. It is with the last encumbrance that appellants take issue.

"They contend that the $2,000,000 mortgage, insisted upon by the bank at a time when the project was in financial straits, constituted grossly excessive security in view

of the fact that the bank already held mortgages with a face value of $1,750,000 for loans of precisely that amount. They claim that the result of this transaction, which placed an encumbrance of $3,750,000 on their land, was the destruction of the project." 426 F. 2d at 1012-1013.

3. The 196 Cuerda Property

"In 1960 Las Colinas purchased three tracts totalling 390 cuerdas from the Penedo family, giving a purchase money mortgage as security for part of the price. Upon a default in payment, the Penedos foreclosed the mortgage and the bank purchased a 196 cuerda portion of the property at a judicial sale. Appellants now seek to have the bank divested of title on the ground that the purchase money mortgage given Penedo was void for failure to comply with Section 215 of the Mortgage Law, 30 L.P.R.A. Section 215 (1966), which provides, in essence, that where several estates are mortgaged to secure a single obligation, the amount of the lien borne by each must be set forth in the instrument:" 426 F. 2d at 1015.

After review of the material issues, the Appellate Court decided that our judgment of January 13, 1969 should be vacated. In addition, the case was remanded for appropriate findings of fact after a complete re-examination of the evidence on the issue of whether the parties intended the financing to be a revolving line of credit. On the issue concerning the execution of the $2,000,000 mortgage, the case was remanded for a determination of damages. The Court also directed that the Bank be divested of title to the 196 cuerdas purchased at judicial sale and that the parties be returned to the status quo.

Pursuant to those directions, this Court entered its order of July 28, 1970 divesting the Bank of title to the 196 cuerda property and returned the parties to the status quo. And, on petition of the Debtors, we entered our

order of August 28, 1970 directing the Bank to return and surrender the $2,000,000 mortgage note. We also directed the parties to file memorandum dealing with the matters remaining in controversy, and they have done so.

After a careful re-examination of the record in this case, as directed by the Appellate Court, and taking into consideration the conclusions of that Court as to matters of law and the weight and sufficiency of the evidence dealing with the related relevant facts, this Court has now resolved the pending matters favorable to the Debtors and adversely to the Banco Popular.

1. The Loans

There is no disagreement that the parties entered into an agreement under which the Bank eventually granted a line of credit amounting to $1,750,000, under which, the source of repayment was to be the sale of lots and houses upon completion. It is also clear that by December of 1963 the work on the project including site development of Section I and the construction of 81 houses therein, was in a relatively advanced state, although not complete, and that the debt then amounted to the precise numerical amount of the line of credit. As noted by the Appellate Court, however this does not conclude the matter.

The issues in controversy of central importance deal with the closely interrelated facts related to, 1) the scope of work to be completed with funds supplied by the Bank, 2) the amount of the accepted budget, and 3) whether or not the credit granted by the Bank was of a revolving character. Following the letter and spirit of the opinion issued by the Appellate Court, and after our re-examination of the evidence, we must find, as we do, that the scope of work to be completed with funds to be supplied by the Bank and the budget for completion of said work which was accepted by

the Bank amounts to a sum substantially greater than the actual amount of the line of credit. We accordingly must also find, as we do, that the financing agreed upon by the parties contemplated the use of a revolving line of credit, for, as noted in the opinion, "only by viewing the $1,750,000 as a revolving credit line could completion become a reality". 426 F. 2d at 1011.

The Debtors' contention that the Bank had agreed to finance the site development for Section I, and the construction of 92 houses is amply supported by the evidence. We are mindful that the written internal bank loan memorandum entered in evidence at the trial (Ex. 43) only shows that the Bank agreed to finance the construction of 46 houses; however, as noted in the Opinion, "Kalisch a Bank officer testified that these forms are administrative guides, they do not necessarily represent the facts as they existed". 426 F. 2d at 1012. On the contrary, the only unimpeached documentary evidence, a report issued by the Federal Deposit Insurance Corporation (Ex. 52) shows that the Bank's commitment was to finance the construction of 92 houses in Section I. This report should furnish the most reliable evidence of the true situation, *Jeffrey's* v. *O'Neal*, 4 Cir., 1933, 64 F. 2d 284, 288.

This is further substantiated by the actual conduct of the Bank during the period of operations, as shown by the related documentary evidence. The amount of the budget tendered to the Bank for completion of Section I, and the construction of 92 houses, together with general administrative expenses totalled $2,771,467.82. This is the so called "Arenas Final Budget". As noted in the opinion:

> "Notwithstanding their disagreement respecting the total cost of completing section one and the manner of repayment, the parties stipulated as to the mechanism by which the work was to be financed as it proceeded.

> Arenas would submit for approval cost estimates requesting funds for a specified purpose. Subsequently, requisitions would be submitted to the bank showing that the purpose of the amounts requisitioned was in the amount shown in the previously accepted cost estimates. The record discloses that the requisitions submitted and approved subsequent to May 15, 1963, gave the amount of the budget for house construction as that stated in the Arenas Final Budget."

The Debtors have pointed out that the Arenas Final Budget was prepared upon the request and with the assistance of Soto a Bank officer, and that this budget was incorporated upon newly designed requisition forms which were admittedly used by the Bank as a control device to show that each particular request for an advance was within the contemplation of the loan agreement. Although this evidence is not conclusive; it must be given strong consideration by the Court, *Rutledge* v. *Gill*, 1955, 78 P.R.R. 665, 672. These factors, together with the conclusions arrived at dealing with the scope of work approved by the Bank, lead us to the conclusion that the Bank did accept the Arenas Final Budget. Nevertheless, even if this were not so, the Bank, through its Counsel at the trial, was willing to admit that the final extension of the line of credit,

> ". . . was approved for completion of site development, completion of model houses and 46 other houses, and administrative expenses, partial financing of other houses being built by Debtor without prior consent of the Bank and other credit needs of the Debtor." (Reply to Request for Admissions No. 31, filed March 21, 1968)

The accepted budget for this work, together with other work also admittedly approved, reaches a sum total very

substantially above the amount of the line of credit, by the Debtors' calculations, a total of more than $250,000 in excess of the line of credit. The work could not have been completed unless the line of credit was of a revolving character. The Bank offered no direct evidence to sustain its present position that the parties did not contemplate the financing to be of a revolving nature. On the contrary, Jose Luis Carrion, Executive Vice President of Banco Popular, testified that the second $500,000 line of credit for house construction was a revolving loan, and there is no evidence to show that this commitment was ever abrogated. See: *Caribe Lumber Co.* v. *Marrero*, 1955, 78 P.R.R. 826, 833. Such documents as were admitted in evidence merely speak of the Bank's commitment to a $1,750,000 "line of credit" absent further clarification. The accepted meaning of this term is a credit accommodation of a continuing or revolving character, *Schneider-Davis Co.* v. *Hart*, 1900, 23 Tex. Civ. App. 529, 57 S.W. 903. Moreover, as between the beneficiary and the issuer of such a credit, if ambiguity exists in the meaning of the document, "the words are taken as strongly against the issuer as a reasonable reading will justify" *Venezelas, S.A.* v. *Chase Manhattan Bank*, 2 Cir., 1970, 425 F. 2d 461, 466.

The Debtors' president, Vigdor Schreibman and their former comptroller, Ramon Santiago, both specifically testified that the contemplated financing was to be of a revolving character. Considering the crucial importance of this issue and the clear preponderance of damaging evidence resting before the Court, it was incumbent upon the Bank to convince the Court, with direct evidence, that the lines of credit were not of a revolving character, if it were to sustain its position. *Heim* v. *Universal Pictures Co.*, 2 Cir., 1946, 154 F. 2d 480, 490-491. This the Bank has failed to do. We therefore conclude that the Bank did, as evidence

shows, commit itself to revolve the line of credit which was granted.

Notwithstanding its commitment to revolve the line of credit, the Bank judicially admitted at the trial, as the Court found at paragraphs 29 and 30 of the Pretrial Order, that when the subject was raised in December of 1963, the Bank absolutely repudiated their agreement.

2. The $2,000,000 Mortgage

It was in this state of affairs that the Bank then requested the $2,000,000 in additional mortgage security. This security was received by the Bank by virtue of a corporate resolution dated December 20, 1963 in which the president of Las Colinas was authorized to execute a promissory note secured by a mortgage for $2,000,000 "as additional security of loans made prior to this date and as security of advances to be made by the banking institution subsequent to this date." This resolution was carried out under the controlling votes of two officers of the bank while they both occupied dual positions as fiduciaries to both the bank and Las Colinas. In its opinion, the Appellate Court found that these facts casts upon the bank in seeking to uphold the transactions, "the burden of showing that it is fair and absolutely free from fraud".

Upon review of the record, the Court of Appeals found that, at the time of this transaction, the bank otherwise held mortgage security with an actual value to the precise amount of the debt and that although it was claimed that negotiations for future advances were taking place, "no such loans ever materialized". The Court then concluded that "the record reflects an utter failure to demonstrate the fairness of the transaction". Having found that the bank had failed in its burden to show that the security was not grossly excessive in light of the surrounding cir-

cumstances, the Court decreed that the debtors are entitled to receive such damages as they have shown resulted from this transaction, and remanded this segment of the case for a determination of the amount of damages. We have noted in our order of August 28, 1970 that:

> "The continued possession of the $2,000,000 mortgage by the Banco Popular presumptively constitutes a practical obstacle in the way of procuring the funds required for completion of the project on any terms, and has the effects of preventing the debtors from operating their business and of obstructing these proceedings."

Upon the record before the Court, we reaffirm this conclusion.

3. Conclusions

We then have the situation where the Bank first repudiated the revolving nature of the line of credit and effectively refused to advance the funds which it had agreed to advance. Then, by a legal breach of trust against Las Colinas by the Bank's officers, it obtained the $2,600,000 mortgage security, thus preventing and hindering the developers from being able to raise the funds for completion of the project elsewhere on any terms. It was furthermore admitted, as noted in the Appellate Court's opinion, that the Bank claims the line of credit, "was a gross amount to be paid in a lump sum", and that it absolutely refused to release any of the lots and houses, or any of the mortgages then held without payment of the entire debt in full. This last act prevented the sale of lots and houses, and prevented the removal of excess security affecting the development lands, thus precluding the developers from obtaining

further financing for completion of the project. This Court's pretrial order, entered on March 26, 1968, specifically found, at paragraph 12 D, that, "In order to allow the sales of individual houses to purchasers, the Bank would release the individual lots and houses from previous mortgages held thereon. . . ." In addition, the express terms of each of the mortgages involved in this case divide the mortgage obligation among nine (9) individual properties. The Debtors' right to release the excess encumbrances is protected as a matter of public policy. *Marichal v. Court*, 1961, 88 P.R.R. 619, 625. Dealing with the same policy of the law in its opinion, the Appellate Court has this to say:

> "The purpose of that statute was to protect the general credit of the country by preventing creditors from taking excessive security for their debts. *Crédito y Ahorro Ponceño v. Registrar*, 30 P.R.R. 131 (1922), particularly at 133). The vice to be avoided was that the collateral of a debtor would be encumbered to a degree unwarranted by the outstanding debt, thereby preventing him from obtaining further financing." 426 F. 2d at 1017.

The performance by the Bank of its obligation to release the funds agreed upon so as to facilitate completion of the work was an essential part of the contract. Likewise, the agreement to make partial releases of the lots and houses from the mortgage so as to permit their sale, and the obligation to release the individual properties from excess encumbrances so as to permit the developers to obtain further financing, if necessary, were essential parts of the contract, requisite to enable the developers to carry out their part of the agreement.

The advance of such funds or the release of the properties from excess encumbrances so as to enable the developers to obtain the funds required for completion of the project elsewhere, as well as the release of the lots and houses from the mortgages so as to permit their sale, were all necessary to enable the developers to create the source of repayment of the loans which was agreed upon thus, a condition precedent to the enforceability of such obligation. Civil Code, 1930 ed., Sec. 1054 (31 L.P.R.A., sec. 3017). *Guerra Stone Co.* v. *P. J. Carlin Construction Co. (Puerto Rico)* 1919, 248 U. S. 334, 345; *Colberg* v. *Lynch*, 1910, 16 P.R.R. 695.

The Bank cannot enforce payment of the debt without showing its willingness to perform its obligations to loan the funds which it was committed to loan. *Provident Trust Co.* v. *Metropolitan Ins. Co.*, 3 Cir., 1945, 152 F. 2d 875, 877; *Rinbestos-Manhattan Inc.* v. *Asbestos Textile Co.*, 1 Cir., 1935, 79 F. 2d 634. Nor could it enforce payment of the debt without showing its willingness to perform its obligations to make partial releases of the lots and houses and to release the excess encumbrances from record. *Buckeye* v. *Hill Military Academy*, Or., 1950, 223 P. 2d 172. And where the Bank's multiple breaches of the express terms of the contract were not only material, but clearly willful acts, such conduct constitutes a bar to the enforcement of any part of the debt, as well as a bar to the recovery of any security which may be held therefor. *Giller* v. *Gillett*, 9 Cir., 1950, 184 F. 2d 872; *Reid* v. *Electrical Research Products*, 1 Cir. (Puerto Rico), 1932, 57 F. 2d 629, 632.

In addition, regardless of whether or not any of the Bank's obligations could be classified as independent covenants, it is evident that the Bank prevented and hindered the developers from completing the work and selling the lots and houses, itself by breach of the express terms of the

contract and, indirectly, by the breach of trust of the Bank's officers with respect to the $2,000,000 mortgage transaction. The Bank, having willfully breached its contract and having otherwise prevented and hindered the developers from creating the fund from which it was to receive payment, cannot now insist upon its right to payment under the contract. *United States* v. *Peck*, 1880, 102 U.S. 64; *Vandergrift* v. *Cowles Engineering Co.*, App. Div., N.Y. 1900, 55 N.E. 941, 942-943; and see: *Gilbert* v. *California Oregon Power Co.*, 1960, 223 Or. 1, 353 P. 2d 870.

The Bank has offered no meritorious defense to any of the conclusions reached here, which are supported in principal by the Appellate Court opinion, other than its allegation that, even if the Court should find that the line of credit granted by the Bank were of a revolving nature, a repudiation thereof by the Bank was justified. The Bank rests this defense on the following propositions:

1. That Las Colinas was unable to complete the houses, or ready to start delivery of houses and lots soons to start revolving the line of credit at the time that the full amount thereof became exhausted; and,

2. That the developers had committed themselves to complete the work by December of 1963 and their alleged breach of this covenant entitled the bank to rescind the agreement pursuant to Article 1077 of the Civil Code (31 L.P.R.A., sec. 3052).

Actually, the issue raised by the Bank is not one of controlling importance under the conclusions which we have reached. Nevertheless, we will consider the matter in full.

It is no answer for the Bank to now say that Las Colinas was in no way able to complete the construction of the houses, as there was no proof that the work could not have been completed, *Vandergrift* v. *Cowles Engineering Co.* (supra). On the contrary, there is ample evidence to show that the developers would very likely have been able to

complete the work if the Bank had not breached its agreement. This is shown by the Bank's own report on the status of the work at the time. And once the Bank repudiated its obligations, the developers were under no obligation to proceed? Restatement, *Contracts*, sec. 306.

Nor was it shown upon competent evidence that the developers were otherwise in default of their obligations in such respect so as to warrant the Bank's repudiation of its obligations and abandonment of the contract entirely. The Bank did not establish a specific date for completion of the work. In fact, it admits that "there is no conclusive evidence as to the existence of an express agreement regarding the time the parties thought would be required to finish the works already started." Such testimony as was offered by Soto and Kalisch, in this respect, was rejected by the Appellate Court as, "extremely tenuous." On this point, it is the Bank's burden, if it hopes to recover upon the contract or defeat a recovery for damages for breach of contract, to either show that the developers had broken a dependent part of the agreement without fault of the Bank or that it would have otherwise been impossible for the developers to have complied with their part of the agreement. Restatement, *Contracts*, sec. 315 (1) (a), (2); *Vaudelgrift* v. *Coules Engineering Co.* (supra). As noted, the Bank has not met this burden. Or controlling importance, in any event, is the fact that, under the circumstances present, a covenant dealing with completion time could not be considered as of a "reciprocal character" which would permit a recession of the contract pursuant to the provisions of Article 1077 of the Civil Code, as contended by Counsel, *Municipality* v. *Vidal*, 1945, 65 P.R.R. 346; *Holt* v. *United Security Life Ins. & Trust Co.*, N. J. App. 1909, 72 A. 301.

The Debtors have prayed the Court for judgment in damages against the Bank caused by its wrongful conduct, allegedly in the total amount of some 4.6 million dollars.

Memorandum Opinion of the District Court for Puerto Rico per Cancio, Chief Judge:

Alternatively, they are willing to forego their claim for damages in favor of judgment for a dismissal and discharge of the Bank's claim against the Debtors, in its entirety. Damages resulting from the Bank's wrongful conduct were, of course, severe; nevertheless, we conclude that the latter form of relief is most suitable under the circumstances present. Judgment should, therefore, be entered dismissing the Bank's claim against the Debtors and providing that the Debtors' debt to the Bank in the principal amount of $1,776,532.62, plus interest, be discharged in its entirety.

In conclusion, we note that this controversy between the Banco Popular de Puerto Rico and the Debtors has involved a lengthy and complicated litigation. This Court has not always ruled with the Debtors. On numerous occasions, this Court was persuaded by the contentions of the Banco Popular. Nevertheless, by the process of sifting these issues among the impartial and sound legal minds of the Judges of our judicial system who have from time to time dealt with the issues present, and the parties having been vigorously represented by their respective attorneys, this Court's present conclusions have arisen out of the best possible conditions, and we are satisfied with the results attained in the name of justice.

Judgment will be entered accordingly.

Dated this 31st day of December, in the year 1970.

/s/ HIRAM R. CANCIO
Hiram Cancio
Chief United States District Judge
for the District of Puerto Rico

FILED & ENTERED
DEC 31, 1970
CLERK, U. S. DISTRICT COURT
SAN JUAN, PUERTO RICO

Judgment of the District Court for Puerto Rico

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

No. 38—64

IN THE MATTER
of
LAS COLINAS, INC. and
EASTERN SHORE DEVELOPMENT CORPORATION,
Debtors.

December 31, 1970

JUDGMENT

In the matters related to the controversy between the Debtors, Las Colinas, Inc. and Eastern Shore Development Corporation, and the Banco Popular de Puerto Rico, subject of our memorandum opinion issued this same date, it is hereby ORDERED:

1. That the claim for collection of debt in the principal sum of $1,776,532.63 together with interest and fees filed by the Banco Popular de Puerto Rico against Las Colinas, Inc. is hereby denied in all respects.

2. That the alternative counterclaim for dismissal of the suit filed by the Banco Popular against said Debtors and for the discharge of said debt in its entirety, as prayed for by said Debtors, is hereby granted in all respects. Said debt in the principal amount of $1,776,532.63, together with interest, is hereby held to be discharged in its entirety and henceforth held for naught.

3. That Banco Popular is further ordered to return to the Debtors in Possession within thirty (30) days of the entry of this order each and all of the original promissory and mortgage notes issued by Arenas, Inc. and Las Colinas, Inc. with respect to the financing subject of their controversy presently in the possession of said Bank; to wit:

A. Eighty-three (83) promissory notes made to the order of Banco Popular de Puerto Rico dated between April 27, 1962 and December 27, 1963 executed by Arenas, Inc., showing a total principal amount of $1,776,532.63; copies of which notes were admitted in evidence herein as Debtors' exhibit 14.

B. A mortgage note payable to the bearer, dated April 26, 1962 and executed by Arenas, Inc. in the principal amount of $500,000, copy of which note was admitted in evidence herein as Debtors' exhibit 20.

C. A mortgage note payable to the bearer dated February 5, 1963 and executed by Arenas, Inc. in the principal amount of $500,000; copy of which note was admitted in evidence as Debtors' exhibit 21.

D. A mortgage note payable to the bearer dated February 4, 1963 and executed by Las Colinas, Inc., in the principal sum of $750,000; copy of which note was admitted in evidence herein as Debtors' exhibit 44.

Dated this 31st day of December, 1970.

/s/ HIRAM CANCIO
Hiram Cancio
Chief, United States District Judge
for the District of Puerto Rico

FILED & ENTERED
DEC 31, 1970
CLERK, U.S. DISTRICT COURT
SAN JUAN, PUERTO RICO

Opinion of the Court of Appeals for the First Circuit, per Coffin, Circuit Judge

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 71—1047

IN THE MATTER
of
LAS COLINAS, INC., et al.,
Debtors,
BANCO POPULAR DE PUERTO RICO,
Appellant.

No. 71—1048

IN THE MATTER
of
LAS COLINAS, INC., et al.,
Debtors, Appellants.

December 21, 1971

COFFIN, Circuit Judge. This is the third occasion for us to consider the trials and tribulations of a residential housing development project on the eastern coast of Puerto

Rico.* In our last review, we remanded the case to the district court to reexamine the evidence and decide whether the debtors in possession of the project, Las Colinas, Inc., and Eastern Shore Development Corporation [Las Colinas] and their bank, Banco Popular de Puerto Rico, intended credits totalling $1,750,000 to be "revolving", i.e., a maximum exposure within which proceeds of sales of houses would be paid to the bank, releasing like sums for financing of future construction, or a fixed amount to be paid at the due date in one sum. A second issue involved a $2,000,000 mortgage given by Las Colinas to the bank which we found, in view of the circumstances of its execution and the value of pre-existing security for the debt owing the bank, to be grossly excessive and unfair." We therefore also remanded the case for a determination of damages.

The district court, as to the first issue, reviewed the evidence and concluded that the bank had committed itself to revolve the $1,750,000 line of credit. In so doing it found that the bank had accepted a work plan or budget which contemplated the gross expenditure of funds much greater than the line of credit approved, indicating an intent that the credits be turned over as sales proceeds were received and paid to the bank; that a Federal Deposit Insurance Corporation report revealed that the scope of the bank's financing encompassed the entire project rather than the half of the project which the bank contended was its more limited objective—a scope inconsistent with its contention that the credits were to be repaid on completion of half of

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* The first was a review of efforts to transfer a Chapter XI proceeding to one under Chapter X. *Schreibman* v. *Mason*, 377 F. 2d 99 (1st Cir. 1967). The second, containing a general description of the factual background germane to this appeal, was a review and reversal of bankruptcy court action permitting a bank creditor to have some of the debtors' mortgaged property sold at public auction. *In re Las Colinas, Inc.*, 426 F. 2d 1005 (1st Cir. 1970).

the houses; and that the bank acknowledged that its advances were to be used for houses in addition to the alleged half-way cut-off. The court also noted the specific testimony of debtors' officials, to which it obviously gave credence, that the financing was to be of a revolving character. The bank makes arguments as to the significance of the work plan or budget, the F.D.I.C. report, the credibility of bank witnesses, and the incredibility of debtors' witnesses, all of which were pertinent at the trial level but fall short of demonstrating to us lack of support for or clear error in the district court's decision.

On the second issue, the determination of damages, the court properly found that the bank, when debtors were about to begin realizing sales from their properties and to be able to replenish the purse that fed them, changed the rules and demanded full payment for all monies advanced, refusing to release any encumbrance on properties to be sold, and thus repudiating the contract. In addition to this, credit freeze was the arctic chill of the illegally superimposed $2,000,000 mortgage, forestalling resort to other sources of financing. Accordingly, the court held that the bank could not insist on repayment of the indebtedness of some $1,776,532 due it. But as to the debtors' claim for additional damages in the amount of $2,756,792, the court concluded that cancellation of the debt in the amount of $1,776,532 was enough—"most suitable under the circumstances present".

The court, proceeding Solomonically, noted that the debtors had expressed themselves as "willing to forego their claims for damages in favor of judgment for a dismissal and discharge of the Bank's claim against the Debtors, in its entirety". Debtors now complain that their "alternative" offer was not meant to come into play until there had been a specific finding that their claim for damages was not greater than the amount of their debt to the

bank, and that this finding was not made. They added yet another proviso at oral argument: that if we are unable to determine additional damages from the record before us, they would prefer to let matters stand as the district court disposed of them rather than to be subjected to the burden of another attenuated proceeding.

We accept their offer. While the district court did not follow with precision the course we charted, it arrived at a result both sensible and, we think consistent with the nature of the claims made. From the debtors' point of view, in order to be made whole, they would have to be compensated for the following elements of damage: the increases in costs of completion stemming from the changes in economic conditions between 1963 and 1970; additional administrative and prepaid expenses, and taxes caused by delay; their lost revenues from rental of all houses and lots on the section being developed; their lost interest on the value of land not being developed; and attorney's fees and expenses. Debtors have woven a fine skein from the testimony of various witnesses, arriving at a grand total of damages of $4,533,324. But many of the threads are fragile, and the final web is too gossamer to bear weight.

We must note that a housing development is by definition a new venture, a speculation. What costs would have been, what sales or rentals would have been, what the economy would have been for buyers and borrowers, in a relatively undeveloped and remote part of Puerto Rico, are questions we cannot answer with any confidence from an inconclusive record. We suspect that the district court would take a similar view. For debtors to prevail, they must persuasively prove that completion would have proceeded without complication, that all houses and lots in their developed area would have been sold or rented without difficulty, and that even their undeveloped land would have a market. Were we to remand for a more precise determination, we

would think it probable that a substantial part of the damages claimed would be deemed too speculative and remote. *See* Restatement of Contracts § 331, illustrations 6 and 8 at 519 (1932). As to § 331, subsection (2), which would give rental value if there is no basis to estimate lost profits, we have found no case where rental value has been awarded on undeveloped, still speculative properties.

We think, rather, that the appropriate rule for damages is that contained in Restatement of Contracts § 333 (1932): "The amount of the plaintiff's expenditure, reasonably made in performance of the contract or in necessary preparation therefor . . . [minus] the value of the material on hand, . . ." *See* comment b at 526-27, and illustrations 1, 5, and 6 at 528-30. *See also* § 343, illustration 2 and 3 at 564-65, illustration 14 at 582; 5 Corbin on Contracts § 1031 (1964); *United States* v. *Behan*, 110 U.S. 338 (1884); *Robie* v. *Oliant*, 306 F. 2d 656 (1st Cir. 1962); *Dade County, Florida* v. *Palmer & Baker Engineers, Inc.*, 318 F. 2d 18 (5th Cir. 1963), 339 F. 2d 208 (5th Cir. 1964).

While debtors' expenditures in reliance on the bank's undertaking, plus such losses as are capable of measurement, minus the present value of improvements, may not be in an amount identical to the monies advanced by the bank, we think that these net damages caused by the bank's default and over-reaching are approximately equivalent to the credits extended by the bank. We therefore think that substantial justice was done in relieving debtors of the burden of repayment of their indebtedness to the bank and that a remand would only protract already over-extended litigation while producing substantially the same result.

Affirmed.

ENTERED
DEC 21, 1971